

SMALL BUSINESS ISSUES AND
PRIORITIES—1987

BY STAFF MEMBERS OF THE
COMMITTEE ON SMALL BUSINESS
UNITED STATES SENATE
WITH
REPRESENTATIVES
OF
SMALL BUSINESS ORGANIZATIONS



FEBRUARY 25, 1987

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CONTENTS

Statement of Senator:	Page
Dixon, Hon. Alan J., a U.S. Senator from the State of Illinois.....	4
Statement of:	
Andrews, Sue, president, Andrews Properties, Inc., Nashville, TN, representing the National Federation of Independent Business, Washington, DC.....	6
Berno, Donald C., Associate Manager of Legislation, Small Business Center, U.S. Chamber of Commerce, Washington, DC.....	17
Carroll, Francis R., president, Small Business Service Bureau, Inc., Worcester, MA.....	27
Cator, G. Thomas, executive director, Association of Small Business Development Centers, Washington, DC.....	37
Coffey, Mathew, president, National Tooling and Machining Association, Fort Washington, MD.....	64
DeFraites, Arthur A., Jr., chairman, Committee on Federal Procurement of Architectural/Engineering Services, Washington, DC.....	80
Del Brady, Mary, president, National Association of Women Business Owners, Chicago, IL.....	87
Eastman, Hope, legislative committee chairman, National Small Business United, Washington, DC.....	126
Emerick, Arthur, president, Emerick Construction Co., Portland, OR., representing the Associated General Contractors of America.....	129
Greene, Donald F., legislative chairman, National Association of Investment Companies, Washington, DC.....	159
Griffith, Marcus, president, The Hairlox Co., Washington, DC, representing the National Association of Manufacturers, Washington, DC.....	166
Haynes, R. Michael, general counsel, National Association of Small Business Investment Companies, Washington, DC.....	199
Icenhower, Sherry, president, Goldmark International Inc., Arlington, VA.....	206
Littlejohn, Virginia, executive director, Professional Services Council, Washington, DC.....	213
Millikin, Robert, executive director, Columbus Countywide Development Corp., Columbus, OH, representing the National Association of Development Companies, Washington, DC.....	229
Nave, Gary, vice president, Nor-Well Co., Inc., Elizabethton, TN, representing the National Association of Plumbing-Heating-Cooling Contractors, Falls Church, VA.....	237
Price, JoAnn H., chairman of the board of directors, Small Business Legislative Council, Washington, DC.....	260
Sarasin, Ronald A., director, Government relations, National Restaurant Association, Washington, DC.....	296
Schuyler, James H., staff vice president/legislative counsel, National Association of Home Builders, Washington, DC.....	305
Sullivan, M.R., chairman, Government Relations Committee, American Subcontractors Association, Alexandria, VA.....	308
Troll, J. Richard, executive vice president, Association of Independent Corrugated Converters, Alexandria, VA.....	397

APPENDIX

Statement of Cynthia Grantz, president and chairman of the board, Rockford Coatings Corp., Rockford, IL.....	403
Statement of Clovis Haubein, legislative committee chairman, National Farm and Power Equipment Dealers Association, St. Louis, MO.....	414

IV

	Page
Statement of James R. Hulm, president, National Association of Solvent Recyclers, Washington, DC	419
Statement of John D. Abernathy, chairman and chief executive partner, Seidman & Seidman/BDO.....	423
Statement of the Synthetic Organic Chemical Manufacturers Association (SOCMA), Washington, DC.....	437

MEETING DATE

February 25, 1987	4
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SENATE SMALL BUSINESS COMMITTEE ASSOCIATION MEETING

February 25, 1987
SR 428A
9:30 a.m.

MORNING SESSION

PANEL 1

MS. JOANN PRICE
Chairman of the Board
Small Business Legislative Council
Washington, D.C.

MS. MARY DEL BRADY
President
National Association of Women Business Owners
Chicago, Illinois

accompanied by

MS. SHERRY ICENHOWER
President
Goldmark International
Arlington, Virginia

MR. FRANK CARROLL
President
Small Business Service Bureau, Inc.
Worcester, Massachusetts

PANEL II

MS. HOPE EASTMAN
Legislative Committee Chairman
National Small Business United
Washington, D.C.

MR. RON SARASIN
Director of Government Relations
National Restaurant Association
Washington, D.C.

MR. ROBERT MILLIKIN
Executive Director
Columbus Countywide Development Corporation
Columbus, Ohio

presenting: National Association of Development Companies

PANEL III

MR. ARTHUR DEFRAITES

Chairman
Committee on the Federal Procurement
of Architectural/Engineering Services
Washington, D.C.

MR. PAUL E. EMERICK

President
Emerick Construction Company
Portland, Oregon

Representing: Associated General Contractors of America

MR. M.R. SULLIVAN

Chairman
Government Relations Committee
American Subcontractors Association
Alexandria, Virginia

PANEL IV

MR. JAMES SCHUYLER

Staff V.P./Legislative Counsel
National Association of Home Builders
Washington, D.C.

MR. GARY NAVE

Vice President
Nor-Well Company Inc.
Elizabethton, Tennessee

Representing: National Association of Plumbing - Heating -
Cooling Contractors

MR. MATHEW COFFEY

President
National Tooling and Machining Association
Ft. Washington, Maryland

PANEL V

MR. DONALD GREENE

Legislative Chairman
National Association of Investment Companies
Washington, D.C.

MIKE HAYNES

General Counsel
National Association of Small Business Investment Companies
Washington, D.C.

AFTERNOON SESSION

PANEL VI

MS. SUE ANDREWS
President
Andrews Properties, Inc.
Nashville, Tennessee

Representing: National Federation of Independent Business

MS. VIRGINIA LITTLEJOHN
Executive Director
Professional Services Council
Washington, D.C.

MR. DON BERNO
Associate Director
Small Business Center
U.S. Chamber of Commerce
Washington, D.C.

PANEL VII

MR. MARCUS GRIFFITH
President
Hairlox Company, Inc.
Washington, D.C.

Representing: National Association of Manufacturers

MR. RICHARD TROLL
Executive Vice President
Association of Independent Corrugated Converters
Alexandria, Virginia

MR. TOM CATOR
Executive Director
Association of Small Business Development Centers
Washington, D.C.

FEBRUARY 25, 1987

STATEMENT BY SENATOR ALAN J. DIXON

COMMITTEE ON SMALL BUSINESS

AGENDA FOR 100TH CONGRESS

MR. CHAIRMAN, SMALL BUSINESSES CONTINUE TO BE THE BACKBONE OF OUR ECONOMY. THEY ARE THE MAJOR JOB CREATORS IN OUR COUNTRY.

YET, THEY CONTINUE TO NEED OUR ATTENTION AND SUPPORT TO MAINTAIN THEIR PLACE IN OUR ECONOMY.

THIS, THE 100TH CONGRESS, SHOULD MOVE FORWARD IN PASSING THE PROMPT PAY AMENDMENTS AND TO WAIVE THE PRE-PAYMENT PENALTIES.

I AM PROUD TO COSPONSOR THE BILL TO PROVIDE FOR A WHITE HOUSE CONFERENCE ON SMALL BUSINESS ONCE EVERY PRESIDENTIAL TERM.

IN THIS 100TH CONGRESS, THIS COMMITTEE SHOULD PURSUE THE DEFENSE INDUSTRIAL BASE ISSUE; TARGETING THE IMPACT THAT THE LACK OF A COMPREHENSIVE NATIONAL POLICY HAS ON SMALL BUSINESS.

WE SHOULD CONTINUE OVERSIGHT OF AMENDMENTS TO THE SMALL BUSINESS ACT CONTAINED IN THE DOD AUTHORIZATION ACT; AND OVERSIGHT OF COMPETITION ADVOCACY PROGRAMS; AND OF THE SBA CERTIFICATION OF COMPETENCY PROGRAM.

IT IS TRULY HEARTWARMING TO SEE THE LEVEL OF INTEREST AND INVOLVEMENT THE SMALL BUSINESSES OF AMERICA HAVE IN OUR GOVERNMENT AS DISPLAYED BY THEIR TAKING THE TIME AND INTEREST TO BE HERE.

I WANT TO WELCOME ALL OF YOU AND LET YOU KNOW THAT I APPRECIATE AND WELCOME YOUR CONTINUED SUPPORT.

Form 700
500 Maryland Ave. N.W.
Washington, D.C. 20004

(202) 544-6800

National Federation of
Independent Business

NFIB

STATEMENT OF

SUE ANDREWS
PRESIDENT
ANDREWS PROPERTIES, INC.



for
NATIONAL FEDERATION OF INDEPENDENT BUSINESS

Before: Senate Small Business Committee
Subject: NFIB Legislative Priorities for the 100th Congress
Date: February 25, 1987

Mr. Chairman, my name is Sue Andrews. I am President of Andrews Properties, Inc. in Nashville, Tennessee, and I am a member of the Board of Directors of NFIB. On behalf of the more than 500,000 small business member owners of NFIB, I appreciate this opportunity to outline for you and the members and staff of the Senate Small Business Committee our top priority issues for the first part of the 100th Congress.

Because NFIB represents such a large and diverse group of small business owners, our list of critical issues is quite extensive. I ask that this list be inserted in the hearing record, and I will focus my testimony today on several of the issues which we believe merit immediate attention. The issues I will address are important both to the membership of NFIB and to my fellow delegates at the 1986 White House Conference on Small Business.

Tax Rates

Enactment of the Tax Reform Act of 1986 has prompted a lively debate as to the ultimate impact of many of the provisions. Even so, the sharply lower tax rates included in the new law stand as a major legislative achievement that undoubtedly will spur an improved economic climate and promote long range growth. While other reforms may be looked at askance, the tax rates are praised unanimously by small business owners as being effective tools for tax equity and for economic growth.

This year Congress is once again under tremendous pressure to reduce budget deficits. Already the new Speaker of the House, Jim Wright (D-TX), has called for delaying implementation of the rate cuts in order to generate needed revenues.

NFIB will strongly oppose any efforts to delay the effective date of the rate cuts, to delay indexing of these rates, or to increase the rates directly.

Mandated Benefits/Parental Leave

The ongoing Congressional trend to impose on employers specific mandatory employee benefit requirements is an issue of deep concern to small business owners. In the 99th Congress, health plans and pension plans were subjected to new federal requirements, setting specific conditions employers who offer such plans must follow. In

the 100th Congress, a number of mandated benefits proposals are expected to be given serious consideration, particularly in the areas of catastrophic health insurance and parental leave.

The mandated benefits trend is alarming to small business owners. The problem goes beyond the philosophical belief that the ability to provide benefits, and the right benefit mix, are best determined by market conditions and by the needs of individual employers and employees. The provision of fringe benefits is tied directly to several factors, the most compelling of which is business profitability. Many small firms are by nature labor intensive and operate on thin profit margins. A recent NFIB survey shows that 65 percent of small firms offer health insurance; the data also show that some firms struggle to provide basic benefits, and about 1/3 cannot afford health insurance plans at all.

Any attempt to impose specific fringe benefit requirements beyond small business' abilities to pay, or any attempt to build the cost of mandated benefits into the already-escalating and overly-burdensome payroll taxes small firms must contend with will be counterproductive to the goal of ensuring benefits to all employees, and will certainly have a substantial effect on the job-generating capacity of the small business sector.

The small business perspective on mandated benefits must be injected into the national debate. Congress needs to work with small business, not against us. This Committee can be a vital link in the chain by scheduling hearings to gather data on the impact of mandated benefits on small firms, then disseminating this information to colleagues who sit on committees of primary jurisdiction.

While this hearing is taking place, another hearing is being held on the House side of Congress which highlights an immediate concern. The hearing is on "The Family and Medical Leave Act", commonly referred to as the parental leave bill. This bill is strongly opposed by NFIB, and the White House Conference on Small Business delegates made opposition to parental leave -- indeed all mandated benefits -- their number 2 priority out of the 60 recommendations they forwarded to Congress and the Administration.

If this bill were to be enacted, businesses would be compelled not only to provide specified periods of time off to employees for a serious illness and for the birth, adoption, or illness of a child or dependent parent; the employer would also be required to hold open for the employee the same or equivalent job (with equivalent benefits and pay) and continue to provide health coverage during the period of absence.

For the privilege of ensuring the employees' rights to job and benefits, the employer continues to pay benefits while experiencing a loss of productivity due to a reduction in workforce. In a smaller business, this reduction can have serious consequences. And what is the employer's recourse? Leave the slot empty or assume the additional cost of hiring a temporary employee.

The bill as currently written attempts to answer small business' concerns by carving out an exemption for businesses with 15 or fewer employees. This in itself creates problems. Given the widespread dislike among small employers for this type of mandated benefit, the possibility exists that the exemption will act as a ceiling, impeding small business growth. In addition, the belief exists that any exemption for small firms is temporary in nature and that the ultimate intent of the bill's sponsors is to ensure that all businesses fulfill these requirements, regardless of size.

NFIB opposed this legislation when it was introduced in the 99th Congress, and we will continue to oppose the legislation, whether or not it includes an exemption for smaller firms.

Competition from Non-Profits

Government competition in all its forms is becoming an increasing problem for small firms. The full extent of this competition is

difficult to measure because the competition occurs both directly and indirectly. Yet we hear on a regular basis from members about a variety of examples of competition from government agencies and government-subsidized entities.

The area of greatest concern is the unfair competitive threat from non-profits engaged in commercial activities. The federal government subsidizes these organizations through an income tax exemption. State governments offer non-profits income and property tax exemptions. Non-profits also receive a postal rate subsidy, and they are eligible for federal grants. More and more, these non-profits are offering products and services that are and have been widely available in the for-profit sector. Yet the money earned by the non-profit may not be taxed while the for-profit's earnings are.

While there are justifiable reasons for granting tax exempt status over the primary activities of most of these organizations, there is no legitimate basis for extending the exemption to cover commercial activities. NFIB members join with the White House Conference Delegates in their belief that organizations competing in the same marketplace should compete on an equal basis, subject to the same benefits and the same requirements.

As the competition from this sector grows, we will urge the Congress to conduct a thorough examination of the issue and at the very least, consider taxing the business activities of the non-profit.

Dual Shop

Of the many labor/management issues we expect this Congress to act upon, one of the first will be the issue of dual shop.

For many years, the construction industry was one of the most highly unionized sectors of the economy. Now over 70 percent of all private sector construction is controlled by open-shop contractors. It is also important to remember that the construction industry is primarily comprised of small firms.

The dual shop controversy stems from the practice of union shops setting up a separate non-union shop to compete for projects. Construction firm owners can therefore work on both closed-shop and open-shop projects.

Legislation nearly passed last Congress to prohibit dual shop ownership, and supporters of the bill will be on the offensive again this Congress. NFIB opposes the bill because it impairs an

employer's ability to operate his or her business in accordance with the dictates of the marketplace. We believe the bill could also open the way for common situs and multi-situs picketing, and possibly compulsory unionism.

Liability Insurance

NFIB's recent surveys show liability insurance as a continuing problem for small firms, both in terms of availability and affordability.

The liability insurance crisis is a complex problem. For this reason, NFIB has always advocated a comprehensive approach to a solution. We believe changes are necessary in both the civil justice system and in the insurance industry. Tort reform is essential to control the cost of litigation and to restore predictability. Business owners should be accountable only for the results of their own conduct or misconduct. To this end, we support fault-based standards of liability, elimination of joint and several liability, expedited settlement procedures, penalties for frivolous litigation, and caps on court awards and attorney's fees. In product liability cases, we oppose elimination of the right of subrogation.

As to the insurance industry, we support regulatory action at the state level to minimize arbitrary withdrawals of coverage. Requiring minimum notification periods and reasonable cause for cancellations are two specific reforms we will try to achieve.

At the federal level, NFIB urges review of the McCarran-Ferguson Act, specifically aimed at repealing the industry's anti-trust exemption, which we support. We also favor elimination of the prohibition against FTC exercising oversight authority in the insurance industry.

Deficit Reduction/Gramm-Rudman Targets

Reducing the deficit continues to be a priority issue with the small business community. The good news is, there is less red ink flowing from Washington. Government spending grew less than 1 percent in fiscal year 1986. For the decade before, the annual growth rate had been 11 percent. While this is cause for celebration, much work remains to be done. NFIB supported enactment of the Gramm-Rudman-Hollings bill because we believed it to be a tough, effective means of forcing down deficit spending. We continue our support for this landmark legislation, particularly the target mechanisms established by the law. We also support corrections to the sequestration process which would satisfy constitutional requirements.

Worker Training

We are all aware of recent studies that indicate small business is the primary job generator in our economy. Small business is the main source of that most important first job for millions of unskilled workers. For the most part, small employers assume all the costs of training an employee, and the bulk of this training occurs on the job.

The employer and the employee benefit: employers increase the efficiency and productivity of their firm, and employees develop the job skills that will help them throughout their career.

Until recently, the government has focused little attention on the needs of labor-intensive businesses. Because of the increased number of dislocated workers needing retraining, labor-intensive industries are now in the spotlight.

Congress has taken the first step by passing the Job Training Partnership Act, but much more needs to be done. Retraining is an important issue for the small business employer, since these small firms have limited resources to provide extensive in-house retraining. At the White House Conference on Small Business, delegates encouraged Congress to find incentives to promote job

creation and job training in small firms. NFIB believes one effective approach could be to offset the cost of training or retraining with a tax credit. Further, to make it most appealing, we believe the credit should be against a firm's payroll taxes. Most jobs are created in the early years of a business, but often a business pays no income taxes during that period. On the other hand, payroll taxes are a fixed business cost from the first day a small business hires an employee. It therefore makes more sense to offset job training against payroll taxes, and we will urge the 100th Congress to give serious consideration to our proposal.

I thank the Committee again for this opportunity to testify on behalf of NFIB and its members. I will be happy to answer any questions.

269T



Statement of the Chamber of Commerce of the United States

ON: SMALL BUSINESS LEGISLATIVE PRIORITIES

TO: SENATE COMMITTEE ON SMALL BUSINESS

BY: DONALD C. BERNO

DATE: FEBRUARY 25, 1987

The Chamber's mission is to advance human progress through an economic,
political and social system based on individual freedom,
incentive, initiative, opportunity and responsibility.

The U.S. Chamber of Commerce is the world's largest federation of business companies and associations and is the principal spokesman for the American business community. It represents approximately 180,000 businesses and organizations, such as local/state chambers of commerce and trade/professional associations.

More than 91 percent of the Chamber's members are small business firms with fewer than 100 employees, 58 percent with fewer than 10 employees. Yet, virtually all of the nation's largest companies are also active members. We are particularly cognizant of the problems of smaller businesses, as well as issues facing the business community at large.

Besides representing a cross section of the American business community in terms of number of employees, the Chamber represents a wide management spectrum by type of business and location. Each major classification of American business—manufacturing, retailing, services, construction, wholesaling, and finance—numbers more than 11,000 members. Yet no one group constitutes as much as 29 percent of the total membership. Further, the Chamber has substantial membership in all 50 states.

The Chamber's international reach is substantial as well. It believes that global interdependence provides an opportunity, not a threat. In addition to the 56 American Chambers of Commerce Abroad, an increasing number of members are engaged in the export and import of both goods and services and have ongoing investment activities. The Chamber favors strengthened international competitiveness and opposes artificial U.S. and foreign barriers to international business.

Positions on national issues are developed by a cross section of its members serving on committees, subcommittees and task forces. Currently, some 1,800 business people participate in this process.

STATEMENT
on
SMALL BUSINESS LEGISLATIVE PRIORITIES
before the
SENATE COMMITTEE ON SMALL BUSINESS
for the
U.S. CHAMBER OF COMMERCE
by
DONALD C. BERNO
February 25, 1987

I am Donald C. Berno, Associate Manager of Legislation for the Small Business Center at the U.S. Chamber of Commerce. Accompanying me today is Thomas E. Donley, Director of the Small Business Center at the U.S. Chamber of Commerce, who participated in drafting this statement. I am pleased to have this opportunity to present the U.S. Chamber's recommendations on small business legislative priorities.

The U.S. Chamber established a Council of Small Business in 1976 to advise the Chamber on ways to serve better the needs of small business members and to harness more effectively the strength of small business to advance the legislative and other programs of the Chamber federation. The Council is composed of 65 small business representatives from all industry segments across the country. The Council is proud that two of its former chairmen have been Chairman of the Board of Directors for the Chamber, and several members of the Council currently serve on the Board. The Council meets regularly to advise the Chamber's staff on small business priorities and makes policy recommendations to the Board on items of interest to the Chamber's small business members.

On behalf of the Chamber, I am delighted to commend this Committee for its excellent work in representing the interests of small business during the 99th Congress—including reauthorization of the Small Business Innovation and Research Act, passage of amendments to the Prompt Payment Act, and reauthorization of the Small Business Administration as an independent agency. Also, the Committee's many oversight activities, particularly the hearings on the impact of the Tax Reform Act of 1986, the repeal of the onerous record-keeping requirements for auto logs, the need for a national product liability law, and the creation of the Corporation for Small Business Investment, were important to the small business community.

THE CURRENT CLIMATE FACING SMALL BUSINESS

This is a time of unprecedented change in the world's economy. It is marked by tremendous technological advances, worldwide markets brought about through information networks, and the growing importance of technical services to develop, sell, and maintain goods and services in these newly integrated markets.

Small, entrepreneurial businesses in the U.S. have demonstrated their ability to adjust to these changes and to take advantage of emerging opportunities. Nevertheless, many are not surviving, although new businesses are being formed to take their places. Both the failure rate and the start rate for small businesses have set records in recent years.

The most important role for the government regarding small business is what might be called the Hippocratic Oath, "first, do no harm." In other words, help make the business environment as predictable as possible through steady fiscal and monetary policy. Also, the government should pursue policies that make it easier for business to compete and, thus, to create the jobs and wealth so essential to the well-being of the American people.

The federal budget deficit, the trade deficit, the impact of tax reform, the changing structure of our economy (including our integration with the world economy), and the changing structure and needs of the work force will present the small business owner with a variety of challenges. How Congress treats these issues will have an enormous impact on the small business community's ability to create jobs, be more innovative, and continue to make its historic contributions to our national economic growth.

The recommendations of the recently completed White House Conference on Small Business establish an agenda that the small business community believes will facilitate its competing and continuing to lead this country through the longest economic recovery since World War II. The small business community appreciates the leadership of the Committee and its staff in developing the legislation that authorized this event and helping to ensure its success.

I. COMPETITIVENESS: LIABILITY INSURANCE AND INTERNATIONAL TRADE

The unprecedented U.S. trade deficit, which has converted the U.S. from an international creditor into the world's largest debtor, in the past five years, is a symptom of several complex phenomena, including international exchange rates, less developed country debt, declining competitiveness of U.S. businesses in world markets, and foreign trade barriers, among others. U.S. businesses, on the whole, have slightly increased their market share of export sales over the past decade, while imports have increased dramatically. However, smaller businesses, which represent the growth potential in exporting, have not been as successful in increasing their exports.

For a comprehensive statement by the Chamber on the trade problem and on H.R. 3, the Trade and International Economic Policy Reform Act of 1987, I recommend the testimony of William Archey before the Subcommittee on Trade of the House Committee on Ways and Means on February 18, 1987. Mr. Archey is the Chamber's Vice President for International Policy.

Two significant factors that are hurting U.S. business competitiveness that can be addressed immediately by the federal government are the liability insurance problem and the need to make trade policy a higher national priority.

Liability insurance is crucial for any business operation. The prohibitive costs or unavailability of liability insurance, especially in the product liability area, present obstacles for the small business owner who wishes to become involved in exporting.

The number one recommendation of the White House Conference on Small Business concerned what has become known as the "liability crisis." The Chamber urges the Committee to review carefully the recommendations of the Conference in this area. The small business community and the Chamber look forward to working with Congress to pass legislation that will eliminate joint and several liability, cap noneconomic damages, return to a fault-based standard of liability, and limit contingency fees to reasonable amounts on a sliding scale. These and other reforms mentioned in the White House Conference on Small Business will be difficult to achieve this year. The difficulty lies not with lack of support in the business community, but rather with a lack of consensus in Congress on how to proceed. The Chamber urges the Committee to continue its involvement with this important issue during the 100th Congress.

Problems with trade, like our other major national problems, cannot be solved by passing a law or by the federal government's acting alone. Solutions require cooperative effort by government and business at all levels. The three international trade recommendations of the White House Conference on Small Business offer particularly good guidance.

Recommendation 5, the highest of the international trade recommendations, declares that the U.S. trade crisis requires that trade policy become a much higher national priority. Recommendation 5 further states that a Department of International Trade, headed by a member of the cabinet, should be formed to help to elevate trade policy. Also, the President, the Congress, and other departments with trade responsibilities should focus more effectively on coordinating existing export development activities, trade negotiations, achieving increased market opportunities, and protection of intellectual property rights through the current General Agreement on Tariffs and Trade negotiations. These steps are necessary to provide incentives and to assist U.S. businesses, just as other governments are assisting their country's businesses in expanding their international markets.

Recommendation 30 calls for a clarification of the Foreign Corrupt Practices Act, which though well intentioned, is confusing to small and large exporters.

Recommendation 35 calls for new and improved export incentives, which would require no additional federal expenditures. It would simplify and increase the small foreign sales corporation tax credit so that it becomes useful to more small exporters. Also, it would create a competitive export promotion program in federal agencies with export promotion budgets, giving grants to small exporters who have the best ideas for ways to increase their exports. This is similar to the highly successful Small Business Innovation Research Program, which provides grants from the federal government to small businesses to perform research and development.

Also, Congress should keep in mind that small businesses rely to a great extent on imports for their supplies, and any legislation that impedes their ability to obtain those supplies could be a hardship on them.

Finally, it is significant that Speaker of the House James Wright has agreed in principle to allow small business title to be added to H.R. 3, which we expect will address some of the issues we have raised. Perhaps the Senate should consider a similar approach.

II. CHANGING NEEDS OF THE WORK FORCE

America's work force is very different today than it was only 10 years ago. There are more women, more part-time workers, and more highly educated "baby boomers." Small businesses hire more older workers and part-time workers than large businesses and also give most employees their first job experience.

Several issues must be addressed in the context of the changing needs of the work force. The educational system must prepare employees in such a way that they will be able to meet constantly changing needs of employers. There must be adult education programs available for workers to update their skills and maintain their productivity. The federal government has an important but limited role in training and retraining. Under the successful Job Training Partnership Act, the federal government has provided direction and funding for locally designed private sector efforts. The Chamber looks forward to working with Congress to make a good program even better.

Small businesses, being labor intensive, rely heavily on their employees' skills and experience. Every employee counts, and employers strive to keep their employees satisfied and productive. The key to achieving this goal is flexibility in designing benefit packages and work schedules that best meet the needs of employers and employees.

The 100th Congress will consider a variety of issues that threaten this flexibility: mandated parental leave, mandatory health insurance coverage, changes in pension rules, and increases in the minimum wage, all of which are adamantly opposed by the Chamber's small business members. As you know, opposition to mandated benefits was the number two recommendation of the White House Conference on Small Business. The Chamber urges this Committee and its members individually to advocate small business's views on these issues with other Senators throughout the legislative process. We must not burden small businesses with expensive and inflexible mandated benefits, regardless of how well intended they may be.

III. THE FEDERAL DEFICIT

Small business owners are greatly concerned about the federal deficit. For the past 20 years, with the exception of 1969, the federal government has spent more than it has received. This is a concern for small businesses not only because of the impact on capital markets but also because they know that an organization, even one as large as the U.S. government, cannot continue to operate on a deficit for an extended time. The Chamber supports the recommendations of the White House Conference on Small Business--to adopt line-item veto power for the President; to modify the Gramm-Rudman-Hollings Balanced Budget Act to satisfy the Constitutional concerns of the Supreme Court; to implement the Grace Commission recommendations; and to reduce subsidies for the agricultural sector by restoring market incentives. The Chamber strongly encourages the Committee to lead the effort in Congress to increase "contracting out" of commercial goods and services by the federal government, as a means of decreasing federal expenditures and improving government operations.

IV. THE CHANGING STRUCTURE OF THE U.S. ECONOMY

America's economy is changing, from an industrial-base to a service-based economy. This change is being led by the small business community, as indicated by the number of jobs being created in the small business service sector. Slower to change have been the federal government's business data collection and analysis, which are relied on both for policy and business decisions. The Chamber strongly supports the overhaul of the standard industrial classification code, which is badly out of date and substantially underreports the activities of the technical services industries to our economy. This overhaul was announced by the Office of Management and Budget in 1986 after several years of indecision and disagreement within the government.

The Chamber supports three White House Conference on Small Business recommendations to help policymakers and business people respond to economic changes.

Recommendation 51 calls for increased small business representation on government policy and advisory boards. The Chamber applauds this Committee for having established an Advisory Committee several years ago and commends the Federal Reserve Board for having created small business advisory committees in its 12 Federal Reserve Bank districts two years ago. In view of the growing importance of small businesses to the economy, this trend should continue. It should lead to appointments to even more significant boards, such as the Federal Reserve Board itself, for the highest quality people with small business experience.

Also, the Chamber supports Recommendation 25 calling for the establishment of a services industry commission to study carefully current policies governing service industries and to recommend how they can be improved. The commission also would recommend improvements in procurement, contracting out, taxes, capital formation, and benefits and pension policy, among others, to enhance growth in the services sector.

Finally, the Chamber encourages this Committee to respond to Recommendation 39 and to examine the impact on small business of government deregulation. The Chamber believes that despite some dislocations and problem areas, small business overall has been helped by deregulation.

As you may know, the House Committee on Small Business is planning a series of hearings on the changing structure of the U.S. economy later this spring. The Chamber hopes that this Committee will be able to coordinate its activities with the House Committee.

The Chamber also recommends to the Committee the report of the National Commission on Jobs and Small Business. The Chamber was pleased that members of the Senate Committee on Small Business were convenors of the Commission. Staff and business-members of the Chamber and several local chambers of commerce testified before the Commission, and we believe that its overview of small business and its long-term recommendations make an excellent complement to the recommendations of the White House Conference on Small business.

V. OTHER ISSUES OF CONCERN TO SMALL BUSINESS

There are a number of other issues of concern to the Chamber's small business members that it looks forward to addressing with the Committee and Congress.

Now that the survival of the Small Business Administration (SBA) as an independent agency has been assured, the Chamber is very interested in working with the Committee to streamline and improve the SBA's representation of and services to small business. The Chamber believes that this can be accomplished primarily through greater reliance on the private sector. This Committee's efforts in strengthening and expanding the secondary market for SBA guaranteed loans are a prime example of that. The Chamber is disappointed that the Senate could not reach agreement on the House-passed version of legislation to create a Corporation for Small Business Investment late in the 99th Congress and requests that you address that issue early in the 100th Congress. Also, the Chamber would like to begin discussing how the guaranteed loan program and the business development program can rely more on the private sector.

The Chamber supports passage of amendments to the Prompt Payment Act and congratulates the Committee and the Senate for passing those amendments last year. Again, it looks forward to working with you this year on this legislation.

Finally, the Tax Reform Act of 1986 was a "good news, bad news" piece of legislation for the small business community. The "good news" is that when the lower rates are fully phased-in there will be a positive impact on small business. We urge this Committee and Congress to address the "bad news" issues this year. These include, but are not limited to elimination of fiscal year accounting, (which will create havoc when it goes into effect on January 1, 1988), inventory capitalization rules, repeal of the General Utilities doctrine, and the elimination of the capital gains differential. The disincentives to savings and investment represented by the elimination of favorable treatment for capital gains, elimination of the investment tax credit, cut back on research and development credit, and reductions in IRA and other income deferral incentives, will have a very negative longer term impact on the U.S. economy.

This concludes my testimony, and I will be happy to answer any questions the Committee may have.



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TESTIMONY OF

FRANCIS R. CARROLL

PRESIDENT

SMALL BUSINESS SERVICE BUREAU, INC.

544 MAIN STREET

WORCESTER, MA 01601

BEFORE THE

U.S. SENATE

COMMITTEE ON SMALL BUSINESS

WEDNESDAY, FEBRUARY 25, 1987

MR. CHAIRMAN, I WANT TO THANK YOU FOR THE OPPORTUNITY TO ADDRESS THE PRIORITIES FOR THE SENATE COMMITTEE ON SMALL BUSINESS OF THE 100TH CONGRESS. MY NAME IS FRANCIS R. CARROLL AND I AM HERE TODAY AS PRESIDENT OF THE SMALL BUSINESS SERVICE BUREAU, INC., AN ORGANIZATION REPRESENTING OVER 35,000 SMALL BUSINESSES WHICH ARE MOM AND POP TYPE COMPANIES FROM ACROSS THE COUNTRY. I AM ALSO A MEMBER OF THE SENATE ADVISORY COUNCIL TO THE SMALL BUSINESS COMMITTEE.

I WILL FOCUS MY REMARKS ON ISSUES PARTICULARLY IMPORTANT TO VERY SMALL BUSINESSES AND SELF-EMPLOYED INDIVIDUALS.

HEALTH CARE

THE NUMBER ONE ISSUE FACING SMALL BUSINESS OWNERS TODAY IS ACCESS TO QUALITY AFFORDABLE HEALTH CARE FOR THEMSELVES AND THEIR EMPLOYEES. THERE ARE SEVERAL PROPOSALS BEING CONSIDERED BY CONGRESS WHICH WILL DETERMINE THE FUTURE DIRECTION OF THIS COUNTRY'S HEALTH CARE SYSTEM. WE HAVE REACHED A CROSSROAD REGARDING HEALTH CARE POLICY IN AMERICA. CATASTROPHIC HEALTH COVERAGE, UNIVERSAL ACCESS TO HEALTH CARE SERVICES, AND PARENTAL LEAVE ARE ISSUES WHICH WILL HAVE A PROFOUND IMPACT ON THE SMALL BUSINESS COMMUNITY. ADDRESSING THESE CONCERNS POSES A MAJOR CHALLENGE TO THE PUBLIC AND PRIVATE SECTOR. THE GROUNDSWELL OF SUPPORT FOR LEGISLATION IS A CALL FOR CONGRESS AND THE BUSINESS COMMUNITY TO COOPERATE IN DEVELOPING POLICIES WHICH WILL BE AFFORDABLE, EQUITABLE, AND WHICH WILL ENCOURAGE PRIVATE SECTOR PARTICIPATION.

FOR NEARLY TWENTY YEARS NOW THE SMALL BUSINESS SERVICE BUREAU HAS BEEN ACTIVE IN THE HEALTH CARE POLICY-MAKING PROCESS AT THE STATE AND FEDERAL LEVELS OF GOVERNMENT. IF CONGRESS VOTES TO MANDATE HEALTH INSURANCE BENEFITS FOR SMALL BUSINESSES, I WOULD LIKE TO DISCUSS THE ISSUE OF HOW MANDATED HEALTH INSURANCE BENEFITS WOULD AFFECT SMALL BUSINESS AND SUGGEST ALTERNATIVES FOR YOU AND THE CONGRESS TO CONSIDER TO MAKE THESE MANDATES ACCEPTABLE AND AFFORDABLE TO SMALL BUSINESS.

WHILE SMALL BUSINESS IN AMERICA GENERATES MOST OF THE NEW JOBS IN THE ECONOMY, THEY ARE THE LEAST ABLE TO AFFORD TO OFFER EMPLOYEE BENEFITS. CONSIDERING THAT EIGHTY PERCENT OF AMERICAN PROPRIETORSHIPS HAVE SALES OF LESS THAN FIFTY THOUSAND DOLLARS ANNUALLY, AND PAY AS MUCH AS TWO HUNDRED PERCENT MORE FOR COVERAGE THAN EMPLOYEES OF LARGE COMPANIES, THIS IS NOT SURPRISING. WITH THESE STATISTICS IN MIND, THE CHALLENGE BEFORE US IS TO PROVIDE THE PROTECTION OUR WORKERS NEEDED WITHOUT CRIPPLING THE VITALITY OF THIS IMPORTANT SECTOR OF OUR ECONOMY.

THE WORD "MANDATE" HAS TRADITIONALLY BEEN A RED FLAG FOR SMALL BUSINESS OWNERS, BUT SBSB MEMBERS NOW REALIZE THAT THE TIME HAS COME TO FACE THE HEALTH CARE CRISIS AND RESPOND TO FEDERAL INITIATIVES WITH CONSTRUCTIVE IDEAS INSTEAD OF KNEE-JERK CRITICISM.

IF CONGRESS MANDATES COVERAGE WITHOUT ADDRESSING THE UNDERLYING PROBLEMS OF ACCESSIBILITY AND AFFORDABILITY FOR SMALL BUSINESSES, YOU WILL BE DOING A GRAVE DISSERVICE TO AMERICAN PRIVATE ENTERPRISE AND ALL TRULY SMALL "MOM AND POP" AND FAMILY-OWNED BUSINESSES IN YOUR STATE. IF CONGRESS SHOULD MANDATE A MINIMUM LEVEL OF COVERAGE, I WOULD LIKE TO OFFER SOME ALTERNATIVES FOR YOUR CONSIDERATION:

2.

1) PROVIDE INCENTIVES FOR SMALL BUSINESSES TO JOIN PRIVATELY MANAGED INSURANCE POOLS. IF, FOR EXAMPLE, SMALL FIRMS WITHOUT HEALTH PLANS ARE ASSESSED A PAYROLL TAX, THEN BUSINESSES THAT DO JOIN THESE POOLS SHOULD BE GIVEN A TAX CREDIT. THIS TAX CREDIT WILL ENSURE THAT MANDATED HEALTH COSTS WOULD NOT IMPOSE AN ADDITIONAL BURDEN ON SMALL FIRMS IN THEIR FIRST FEW YEARS WHEN THEY ARE MOST LIKELY TO FAIL.

2) FOR THE FIRST TIME, THE TAX REFORM ACT OF 1986 ALLOWS THE SELF-EMPLOYED TO DEDUCT 25% OF THEIR HEALTH INSURANCE PREMIUMS. YOU SHOULD MAKE IT 100%.

3) MANDATED HEALTH COVERAGE SHOULD BE DELIVERED THROUGH WELL-RUN, PROVEN AND EFFICIENT MANAGED CARE FACILITIES, LIKE HMOs ON THE LOCAL AND REGIONAL LEVEL.

4) COST CONTAINMENT PROGRAMS NEED TO BE BEEFED UP. SEVENTY PERCENT OF SBSB MEMBERS RESPONDING TO OUR ANNUAL SURVEY SUPPORT INCREASED GOVERNMENT REGULATIONS TO CONTROL HOSPITAL COSTS AND HEALTH INSURANCE PREMIUMS.

IN ADDITION, ANOTHER ALTERNATIVE WOULD BE TO EXAMINE THE POSITIVE ASPECTS OF THE CATASTROPHIC HEALTH CARE PROPOSALS OF PRESIDENT REAGAN AND DR. BOWEN. PERHAPS THE GOVERNMENT SHOULD EVEN CONSIDER HAVING CATASTROPHIC COVERAGE AVAILABLE TO THE GENERAL POPULATION AND PAID FOR OUT OF GENERAL REVENUES. THE GOVERNMENT'S ROLE SHOULD BE TO ENSURE ACCESS, AFFORDABILITY AND QUALITY. ONE MECHANISM THAT COULD BE EMPLOYED BY THE GOVERNMENT TO ASSURE THIS WOULD BE TO REVITALIZE THE HEALTH SYSTEM AGENCIES (HSAs).

THE BUSINESS COMMUNITY MUST SET ASIDE THE CONFRONTATIONAL TACTICS OF THE PAST AND WORK WITH THE GOVERNMENT TO ACHIEVE EQUITABLE SOLUTIONS. IN THIS SPIRIT, I HAVE OFFERED SEVERAL SPECIFIC PROPOSALS TO THE SENATE LABOR AND HUMAN RESOURCES COMMITTEE, AND HAVE EXTENDED THE SERVICES OF MY STAFF TO WORK WITH THEM AND WITH THIS COMMITTEE DURING YOUR FUTURE DELIBERATIONS ON THESE ISSUES.

ON THE OTHER HAND, S. 249, THE PARENTAL LEAVE BILL HAS CAUSED A GREAT DEAL OF DISMAY AMONG OUR MEMBERS. IN A SURVEY WHICH WE CONDUCTED RECENTLY, EIGHTY PERCENT OF OUR MEMBERS OPPOSED FEDERALLY MANDATED PARENTAL AND DISABILITY LEAVE. WHILE SMALL BUSINESS OWNERS BELIEVE THESE ARE WORTHY BENEFITS, THEY FEEL THAT SUCH A MANDATED LEAVE POLICY WILL SERIOUSLY IMPEDE THEIR ABILITY TO RUN THEIR BUSINESSES EFFECTIVELY. THEIR FRUSTRATION IS REFLECTED IN THE SURVEY RESPONSE OF ONE OF OUR MEMBERS WHO STATED, "WE GET SICK AND TIRED OF THE GOVERNMENT TELLING US TO DO SOMETHING THAT WE CAN'T AFFORD TO DO."

WHILE A LARGE COMPANY CAN SPREAD THE WORKLOAD OR HIRE A TEMP FOR AN EMPLOYEE ON LEAVE, THESE OPTIONS ARE NOT FEASIBLE FOR MANY SMALL FIRMS. SOME OF OUR MEMBERS SURVEYED STATED THAT THEY WOULD HAVE NO ALTERNATIVE EXCEPT TO STOP OFFERING BENEFITS ALTOGETHER, OR TO CURTAIL HIRING NEW EMPLOYEES, ESPECIALLY THOSE MOST LIKELY TO TAKE ADVANTAGE OF FAMILY LEAVE.

MINIMUM WAGE

ANOTHER PROPOSAL LIKELY TO ADVERSELY AFFECT THE JOB GENERATING CAPACITY OF THE SMALL BUSINESS SECTOR IS INCREASING THE MINIMUM WAGE. SMALL BUSINESS OWNERS FEEL THAT RAISING THE MINIMUM WAGE WILL ARTIFICIALLY INFLATE PRICES, DRIVE UP OPERATING COSTS, CAUSE LAYOFFS AND INHIBIT THE HIRING OF NEW EMPLOYEES. EMPLOYERS HAVE TO PAY A COMPETITIVE WAGE TO ATTRACT QUALITY WORKERS. THE MARKETPLACE HAS PROVEN THAT THE MINIMUM WAGE CAN BE HIGHER THAN A FEDERALLY IMPOSED WAGE.

THE FORCES OF SUPPLY AND DEMAND SHOULD BE ALLOWED TO WORK FREELY. THE JOB GENERATING CAPACITY OF THE SMALL BUSINESS SECTOR THRIVES IN A FREE MARKETPLACE. CYNICS ASSERT THAT THESE ARE LOW-PAYING SERVICE RELATED JOBS THAT DON'T ENHANCE AMERICA'S PRODUCTIVE OUTPUT. THE SOLUTION TO THIS SITUATION DOES NOT LIE IN ARTIFICIALLY INFLATING WAGES. SUCH POLICIES TREAT ONLY THE SYMPTOMS, NOT THE REAL PROBLEM.

INTERNATIONAL TRADE

THE PROBLEM IS THAT THE U.S. IS LOSING GROUND IN THE INTERNATIONAL MARKETPLACE. "COMPETITIVENESS" IS THE WATCHWORD FOR THE EIGHTIES. WE NEED FARSIGHTED POLICIES WHICH WILL PROVIDE INCENTIVES FOR AMERICAN BUSINESS, AND IN PARTICULAR SMALL BUSINESS TO EXPAND INTO THE INTERNATIONAL MARKETPLACE. COMMERCE SECRETARY MALCOLM BALDRIDGE RECENTLY ANNOUNCED A PROGRAM TO STREAMLINE OUR EXPORT CONTROL SYSTEM.

EXPORT LICENSES HAVE DISCOURAGED POTENTIAL EXPORTERS AND FOREIGN CUSTOMERS FOR U.S. PRODUCTS WITH U.S. GOVERNMENT BUREAUCRACY AND EXPENSIVE REGULATIONS. WE SUPPORT THE ADMINISTRATION'S EFFORTS TO CLEAR AWAY THESE OBSTACLES.

INTERNATIONAL TRADE IS AN AREA WHERE THE UNTAPPED POTENTIAL OF AMERICAN ENTREPRENEURS CAN PLAY AN IMPORTANT ROLE. SMALL FIRMS CAN ADAPT AND READILY RESPOND TO CHANGING MARKET NEEDS. THEY CAN MAKE DECISIONS QUICKLY AND RESPOND WITH COMPROMISE AND FLEXIBILITY.

IT IS TIME TO REJECT THE INEFFECTIVE PROTECTIONIST POLICIES OF THE PAST AND FOCUS ON THE OPPORTUNITIES THAT LAY BEFORE US.

ONE SUCH AREA OF NEW OPPORTUNITIES IS THE PEOPLE'S REPUBLIC OF CHINA. THE "TRAINING FOR TRADE" BILL (S.2918, 99TH CONGRESS) INTRODUCED BY SENATOR JOHN KERRY OF THIS COMMITTEE IS A FARSIGHTED MEASURE WHICH USES THE SAME TACTICS OTHER COUNTRIES ARE USING TO PROMOTE TRADE WITH CHINA, THE LARGEST NEW MARKET FOR AMERICAN PRODUCTS TO OPEN TO AMERICAN BUSINESSES IN THE LAST FORTY YEARS.

"TRAINING FOR TRADE" WOULD PROVIDE TWENTY-FIVE MILLION DOLLARS IN FOREIGN ASSISTANCE FUNDS TO PROMOTE TRADE WITH THE PEOPLE'S REPUBLIC OF CHINA THROUGH A PROGRAM OF TRAINING CHINESE TECHNICIANS AND MANAGERS ON AMERICAN EQUIPMENT, OPENING PROFITABLE TWO-WAY TRADE FOR U.S. FIRMS. IT STANDS TO REASON THAT A CHINESE MANAGER TRAINED ON AMERICAN TECHNOLOGY WILL IMPORT TECHNOLOGY COMPATIBLE WITH U.S. TRAINING. THE SENATOR PROPOSES THAT FIFTY PERCENT OF THE FUNDS WILL BE SET ASIDE FOR SMALL BUSINESSES.

HAVING LEAD FOUR SMALL BUSINESS TRADE MISSIONS TO THE PEOPLE'S REPUBLIC OF CHINA SINCE 1984, I HAVE WITNESSED FIRST HAND THE SUCCESS THAT CAN BE ACHIEVED THERE BY SMALL AMERICAN COMPANIES. CHINA IS AFTER ALL, A NATION OF SMALL BUSINESSES HUNGRY FOR AMERICAN KNOW-HOW. BY HELPING THEM, WE ARE HELPING OURSELVES.

SMALL BUSINESS ADMINISTRATION

IN CLOSING, I WOULD LIKE TO RETURN TO THE OVERSIGHT ROLE OF THIS COMMITTEE. WE ARE RELIEVED TO SEE THE ADMINISTRATION HAS CHOSEN TO RETAIN THE SMALL BUSINESS ADMINISTRATION AS AN INDEPENDENT AGENCY. WE OWE A DEBT OF GRATITUDE TO THE MEMBERS OF THIS COMMITTEE WHOSE OVERWHELMING AND TENACIOUS SUPPORT FOR THE SBA SAVED IT FROM ELIMINATION. WITH A NEW LEASE ON LIFE, THE AGENCY SHOULD REDIRECT ITS PROGRAMS TO ASSIST TRULY SMALL BUSINESSES. SIZE STANDARDS SHOULD BE SCALED DOWN TO SERVE FIRMS WITH 100 OR LESS EMPLOYEES WHERE THE REAL JOB GENERATION AND INNOVATION IS OCCURING IN THIS COUNTRY. IF THE AGENCY DOESN'T HAVE THE RESOURCES TO SERVE FIRMS OF 100 OR LESS, DIRECT ITS PROGRAMS TO SERVE THOSE WITH ONLY FIFTY EMPLOYEES OR LESS.

WE APPLAUD THE PRIVITIZATION OF PARTS OF THE SBA, SUCH AS THE SMALL BUSINESS INVESTMENT COMPANIES. THE SBA SHOULD ELIMINATE THOSE PROGRAMS WHICH COMPETE WITH THE PRIVATE SECTOR. THE AGENCY SHOULD FOCUS ON PROVIDING THE BROADEST RANGE OF BASIC SERVICES TO THE MANY, NOT A SELECT FEW. PROCUREMENT PROGRAMS SHOULD HAVE A SIMILAR FOCUS.

THE MONEY SAVED FROM ELIMINATING THE UNIVERSITY-BASED SMALL BUSINESS DEVELOPMENT CENTERS, COULD BE BETTER UTILIZED BY REVIVING SCORE, A PROVEN PROGRAM OF SOLID MANAGEMENT ASSISTANCE. SCORE SERVICES SHOULD REMAIN AVAILABLE AT A NO COST BASIS.

SECTION 1706

WE HAVE LONG ENDORSED THE CONCEPT OF AN OMBUDSMAN ROLE FOR THE SMALL BUSINESS COMMITTEE. AN EXAMPLE IS THE IMPACT OF SECTION 1706 OF THE TAX REFORM ACT OF 1986. THIS MEASURE SUBJECTS INDEPENDENT TECHNICAL SPECIALISTS SUCH AS ENGINEERS AND COMPUTER SPECIALISTS TO COMMON LAW STANDARDS FOR DETERMINING WHO IS AN EMPLOYEE. THIS ELEVENTH-HOUR PROVISION WAS ENACTED WITHOUT HEARINGS OR FLOOR DEBATE, AND IF IT REMAINS ON THE BOOKS, IT WILL EFFECTIVELY ELIMINATE THOUSANDS OF SMALL BUSINESSES ACROSS THE COUNTRY. I ASK YOU TO SUPPORT SENATOR D'AMATO'S BILL, S. 491, WHICH WILL REPEAL THIS PROVISION.

LIABILITY REFORM

LAST, BUT CERTAINLY NOT LEAST IS THE CONTINUING FIGHT FOR LIABILITY REFORM LEGISLATION. THIS WAS THE NUMBER ONE RECOMMENDATION AT THE 1986 WHITE HOUSE CONFERENCE ON SMALL BUSINESS. SMALL BUSINESSES HAVE BEEN THE BIG LOSERS IN THIS BATTLE. WHILE PREMIUM INCREASES OF FIFTY UP TO FIVE HUNDRED PERCENT WERE SQUEEZED OUT OF SMALL BUSINESSES ACROSS THE COUNTRY, THE PROPERTY-CASUALTY INSURANCE INDUSTRY ON THE OTHER HAND, REAPED A 1986 NET INCOME OF 11.5 BILLION DOLLARS.

SOME LEGISLATORS HAVE NOTED THAT THE NUMBER OF COMPLAINTS BY POLICYHOLDERS TO THEIR OFFICES HAVE LEVELED OFF. WE MUST NOT RELINQUISH THE MOMENTUM ON THIS CRITICAL ISSUE. THE UNAFFORDABILITY AND UNAVAILABILITY OF LIABILITY INSURANCE COVERAGE CONTINUES TO BE A MAJOR THREAT TO SMALL BUSINESSES. I RESPECTFULLY ASK THE MEMBERS OF THIS COMMITTEE FOR YOUR SUPPORT IN ADDRESSING THE ISSUES OF INDUSTRY AND TORT REFORM. THE CURRENT SYSTEM DOES NOT SERVE THE BEST INTERESTS OF EITHER CONSUMERS OR BUSINESS.

THE POLITICAL ATMOSPHERE DURING THE LAST SIX YEARS HAS FAVORED BIG BUSINESS. THE 100TH CONGRESS NOW HAS THE OPPORTUNITY TO HELP SMALL BUSINESS. MANY OF THE ISSUES WE HAVE DISCUSSED HERE TODAY ARE PERCEIVED AS ANTI-SMALL BUSINESS. CONGRESS NEEDS TO TAKE A CLOSER LOOK AT THE IMPACT THESE PROPOSALS WILL HAVE ON AMERICA'S ENTREPRENEURS. THIS COMMITTEE CAN PLAY A MAJOR ROLE IN ENSURING THAT AMERICA'S SMALL COMPANIES GET THE FAIR TREATMENT THEY DESERVE. THANK YOU.

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January 21, 1987

Ms. Johnnie Albertson
Deputy Associate Administrator for
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U.S. Small Business Administration
1441 L Street, NW, Room 317
Washington, DC 20416

RE: Proposed Rule to Govern the Operations of the Small
Business Development Center Program

Dear Ms. Albertson:

This letter of comment, filed on behalf of the 43 members of the Association of Small Business Development Centers (the Association) and reflecting their collective view, is in response to the Small Business Administration's (SBA) proposed rule that would govern the operation of the Small Business Development Center (SBDC) Program. We strongly believe that the rule should be withdrawn.

Our comments are divided into two parts. First, the Association addresses the agency's perceived need for the proposed regulation and analyzes how the regulation is contrary to applicable laws and policies. Second, the Association has undertaken a section-by-section analysis of the proposed regulation and how specific provisions will disrupt the SBDC Program and undermine its objectives.

Ms. Johnnie Albertson
January 21, 1987
Page 2

I. THE PROPOSED REGULATION IS CONTRARY TO THE INTENT OF THE LAW ESTABLISHING SBDCs, INCONSISTENT WITH THE ADMINISTRATION'S STRONG COMMITMENT TO ELIMINATE BURDENSOME REGULATIONS AFFECTING SMALL BUSINESSES AND OTHERWISE ILL-CONCEIVED

SBA's proposed regulation governing SBDCs is not appropriate or justified. President Reagan in submitting his report on The State of Small Business to the Congress in 1986 stated:

• Continued steps to reduce regulatory burdens are important to a healthier small business climate. I call on all Federal agencies to continue to fight to eliminate burdensome regulations and to look askance at proposals for solving every problem with a Federal regulation. The Regulatory Flexibility Act, an important tool for agencies in this effort, requires economic analysis of small business impacts and the consideration of less burdensome alternatives.

If words and commitments to small business have any meaning, SBA should never have allowed this proposed regulation to go forward. It is particularly troubling that repeated efforts by representatives of SBDCs and the small business community to resolve specific issues short of a new regulation have thus far been rejected. Even more alarming is the SBA's justification for a sweeping new regulatory scheme:

The increased size of the Small Business Development Center program over the last few years has necessitated the promulgation of regulations to insure that the program operations are uniform nationwide. (Emphasis added.)

The illogic of considering a Federal regulation to dictate uniform terms and conditions to the state and university partners of the Federal government in administering an SBDC Program under Cooperative Agreements raises the most fundamental questions about the Federal relationship with these administering entities.

To understand how basically wrong it is for SBA to try to impose additional regulatory requirements on SBDCs, it is useful to review the statute which established the SBDC Program in 1980 (P.L. 96-302), subsequent reauthorization legislation (P.L. 98-395) and related legislative history. Without attempting an exhaustive analysis of the laws and their intent, we cite relevant excerpts which establish how the proposed regulation is contrary to what Congress intended. For example, in Senate Report 98-309, Congress states clearly its intent to encourage as

Ms. Johnnie Albertson
January 21, 1987
Page 3

much diversity in the program as there are states participating, not national uniformity.

"It was never the Congressional intent that all SBDC's would operate in the same way, or place the same amount of emphasis on any one area of counseling and training. An integral part of the legislation has always been the flexibility given to each center to tailor its assistance and service activities to the actual needs of the clients in that region. Since 1979, the agency and the Committees have witnessed tremendous -- and often diverse -- growth among the SBDC's reflecting the diversity of the various service areas." (Emphasis added.)

To stimulate diversity, flexibility, innovation, decentralization and a partnership relationship, Congress authorized SBA to make grants to a wide range of entities such as state governmental agencies, universities or colleges, state chartered development, credit or finance corporations, or any combination thereof. It was understandable that Congress would provide great flexibility in how the SBDC Program is to operate. The statute contemplated that SBDCs would provide services extremely broad in scope, including assisting small business in solving problems concerning "operations, manufacturing, engineering, technology exchange and development, personnel administration, marketing, sales, merchandising, finance, accounting, business strategy development, and other matters needed by small business for growth and expansion, innovation, increased productivity and management improvement and for decreasing industry concentration." In rendering these services, Congress only required each SBDC applicant to identify the area to be served, the services to be delivered and how such services would be delivered. As part of its providing services, Congress identified areas for advisory services to be rendered: technology transfer and state and Federal regulatory compliance; identifying private sector consultants, professionals, and organizations; coordinating small business research and in-depth surveys; and furnishing one-on-one counseling.

In short, the statute and its legislative history make clear that each participating state, in partnership with SBA, was expected to frame a program designed to address the unique needs of small business within its own jurisdiction. Variations in how the SBDCs would operate would be infinite. Thus, nothing could stray further from the statute and its purposes than an attempt by the Federal government to impose national uniformity and to micro-manage the program

Ms. Johnnie Albertson
January 21, 1987
Page 4

through a Federal regulation which dictates virtually every detail of how an SBDC can and must operate.

Congress also was explicit that the SBDC Program would be a partnership between SBA and each participating SBDC. Section 2(2) of P.L. 98-395 specifically mandates:

- "(2) The Small Business Development Center Program shall be under the general management and oversight of the Administration, but with recognition that a partnership exists under this section between the Administration and the applicant for the delivery of assistance to the small business community. Services shall be provided pursuant to a negotiated Cooperative Agreement with full participation of both parties."

Basic to SBA's discharge of its statutory duties has been the need to respect its role as a partner with each state SBDC. The legal framework for the partnership has been captured in Cooperative Agreements, a distinct class of Federal/non-Federal assistance relationships which reflects the need to agree mutually on the nature of both parties' rights. The enactment of the Federal Grants and Cooperative Agreements Act in 1978 (31 U.S.C. 6301, et. seq.) was intended to eliminate unnecessary administrative requirements by properly characterizing the relationship between an executive agency and the non-Federal partner. The specifics of who does what and who is responsible for what is expressed in the instrument that defines the relationship, not in a regulation promulgated by the Federal partner to the agreement. Over many years, the Cooperative Agreement instrument has been refined to allow Federal/non-Federal partners to cooperate on significant mutual undertakings. The Cooperative Agreement provides flexibility to update constantly the relationship in light of experience and make needed changes in a timely fashion. Once rigid requirements are incorporated in a regulation, changes will be possible only through amendments to the regulation -- a time consuming and needlessly burdensome and complicated process. The history of the SBDC Program demonstrates that SBDCs must continue to evolve if they are to respond effectively to the dynamic needs of the small business community during a time of unprecedented changes and challenges. Imposing a regulatory scheme which directs how SBDCs must operate to meet these needs and challenges is counterproductive in the extreme. It does violence to the purpose and meaning of the Federal/non-Federal assistance relationship presently embodied in a Cooperative Agreement with each SBDC.

Ms. Johnnie Albertson
January 21, 1987
Page 5

It is the ultimate irony that SBA, the agency charged with enforcing the Regulatory Flexibility Act (RFA), now proposes a rule that would place such rigid and detailed restrictions on SBDCs as to reduce dramatically their flexibility to serve the small business community effectively. The controlling standard for determining that the RFA applies to a particular rulemaking is whether the rule will "have a significant impact on a substantial number of small entities." Since SBDCs' mission is to provide services to small businesses, it is disingenuous in the extreme to certify that the rule will not "have significant economic impact directly on a substantial number of small entities." (Emphasis added). The RFA makes no distinction between a direct and indirect impact as the SBA tries to do in its certification of compliance with the Act. There can be no doubt that the increased administrative burdens levied on SBDCs by the regulation will divert significant time and resources from program activities serving small businesses to reporting and administrative responsibilities that satisfy the bureaucratic needs of the government agency whose mission it is to serve small businesses, SBA. Were SBA to undertake a searching and thorough analysis of the rule's impact (direct and indirect) on the small businesses SBDCs are expected to serve, we are confident that it would conclude that no regulation should be implemented. Such an analysis is required by law.

Having ignored the statute establishing the SBDC Program, violated the Administration's commitment to reduce regulatory and paperwork burdens, and disregarded the Cooperative Agreement and its proper role, SBA also has managed, by promulgating this proposed regulation, to reject applicable OMB Circulars that are based on years of painstaking development and experience by state and local governments, educational institutions, and the Federal government. Inherent in this OMB Circular and legislative standardization process has been the concept of placing greater reliance on non-Federal entities. In the case of state and local governments, the Intergovernmental Cooperation Act of 1967 was passed, in part, for the purpose of achieving greater consistency and simplification in the administration of Federal assistance programs.

Specifically, Office of Management and Budget (OMB) Circulars A-102 "Uniform Administration Requirements for Assistance to State and Local Governments", A-110 "Grants and Agreements with Institutions for Higher Education, Hospitals and Other Nonprofit Organizations", A-21 "Cost Principles for Grants, Contracts and Other Agreements and Educational Institutions", and A-87 "Cost Principles for Programs

Ms. Johnnie Albertson
January 21, 1987
Page 6

Administered by State and Local Governments" are intended to provide direction to the recipients of Federal funds, including those entities administering the SBDC Program. Any changes in the requirements contained in these Circulars has and will continue to be the subject of careful review and deliberation. By way of example, a review of OMB Circular A-102 has been in process for more than two years. Delay in revising Circular A-102 has held up review of OMB Circular A-110. While the President's Council on Management Improvement has established a task force to study Circular A-110, the group will not begin its review of that Circular until after the proposed revision of Circular A-102 is published in the Federal Register. Public comments and suggestions regarding possible changes to Circular A-110 will be solicited. It is important to note that changes made in 1984 to OMB Circular A-122 (cost principles for nonprofit organizations other than educational institutions) have not been made in Circular A-21 governing educational institutions or A-87 governing state or local governments.

In light of the importance the Administration attaches to these government-wide Circulars and its specific commitment to achieving uniformity to a maximum extent when permissible under existing laws, SBA's proposal to add, modify, and change uniform requirements under the applicable Circulars seems highly inappropriate and can only complicate administration of the SBDC Program. Exceptions to these Circulars normally apply only for certain recipients (and not a class of recipient) and only where the Federal agency wants to impose additional requirements on certain recipients, because the recipient has "a history of poor performance, is not financially stable, or its management system does not meet the standards prescribed in the Circular." In these circumstances, the Circular requires the agency to notify the recipient in writing as to why additional standards are being imposed and what corrective action is needed. SBA has failed to demonstrate that any grounds exist to justify imposing additional administrative requirements on SBDCs. Nor does OMB view the imposition of additions to the uniform cost principles favorably. Circular A-21 states: "Agencies are not expected to place additional restrictions on individual items of cost." The irony with the SBDC Program is that the statutory history has provided a legal basis for SBA to reduce regulatory burdens under provisions of existing OMB Circulars -- yet SBA has inexplicably decided to add requirements. The Association believes that there is no justification for requiring universities and state governmental entities to establish special administrative and cost procedures, principles, and policies which are not consistent with well established operating practices and principles applicable to other Federal

Ms. Johnnie Albertson
January 21, 1987
Page 7

assistance programs administered by these same entities.

Surely, SBA, the agency dedicated to the interests of small business, can administer a program intended to serve small businesses through existing OMB Circulars, and SBA's Program Announcements, Policy Manual, Standard Operating Procedures, and the Cooperative Agreements. A reexamination of the array of policy and contractual requirements already in place leads to the conclusion that SBA's priority at this time should be simplification and a reduction of Federally imposed requirements.

The pending threat of a new regulation has already interfered with the program mission of the SBDCs and diverted essential time and effort of key personnel away from the task of serving their small business clients. Accordingly, we strongly request that SBA withdraw the proposed regulation and consider ways to simplify administration and reduce the Federal role. Any SBDC Program issue requiring further attention can and should be addressed by appropriate revisions in existing policy guidelines and mutual understandings between SBA and the non-Federal partners of the SBDC Program under individually crafted Cooperative Agreements.

Since the Association has no assurance that its strong views on the inappropriateness of the proposed regulation governing SBDCs will be favorably acted upon by SBA, we offer the following analysis of specific provisions of the rule and how they are seriously flawed. This analysis is by no means exhaustive but is only illustrative of the deeply serious problems raised by the proposed regulation

II. SECTION-BY-SECTION ANALYSIS OF THE PROPOSED REGULATION ESTABLISHES THAT THERE ARE NUMEROUS AND MAJOR DEFICIENCIES, FLAWS AND UNWORKABLE REQUIREMENTS

129.10 Introduction

The opening section of the proposed regulation illustrates how confusing and counterproductive it is for SBA to try to modify existing Federal rules and policies with a new regulation. It is difficult to understand both the choice and treatment of subject matter SBA attempts to cover in the introduction.

Ms. Johnnie Albertson
January 21, 1987
Page 8

- It states the SBDC Program is a partnership when, in fact, the proposed regulation supercedes the Cooperative Agreement mechanism with a Federally dictated and administered Program which significantly limits the discretionary authority of SBDC sponsors and managers.
- It states that the SBDC Program is decentralized when, in fact, there is proposed a multi-layered and highly centralized management scheme under the exclusive control of the agency.
- It states that the SBDC Program is only a management assistance delivery program of the SBA when, in fact, it is a joint venture between the Federal government and the states that now collectively sponsor hundreds of diversified small business economic development activities.
- It states final authority for terms of the Cooperative Agreement and establishment of program policy rests with SBA when, in fact, the Cooperative Agreement is, as its name implies, now cooperatively drafted and entered into between two equal partners and program policy is now mutually determined between the two partners, SBA and the host sponsor.
- It states that it is the responsibility of the SBDC to foster a productive relationship with SBI, SCORE, and ACE and that SCORE and ACE representatives should serve on SBDC Advisory Boards when, in fact, SBDCs exercise no authority over any of these SBA sponsored programs. SBDCs are not in a position to enter into a relationship with any of these programs, unless SBA and the on-site managers of those programs and their participants deem it appropriate. The composition of SBDC Advisory Boards

Ms. Johnnie Albertson
January 21, 1987
Page 9

should be left to the complete discretion of the states who are in the best position to know the types of representatives needed to make the SBDC as effective and responsive as possible.

- 129.10 (a) Describing the SBDC Program as a "small business management assistance delivery program of the SBA" is too limiting. The proposed wording suggests a single, limited program objective rather than a program with long-term, flexible growth potential. The proposed language does not accurately reflect Cooperative Agreement activities already being undertaken by SBDCs with the written concurrence of SBA. At a minimum, the paragraph should be reworded to broaden its scope and emphasize the evolutionary role that an SBDC plays in overall small business economic development activities as individual state programs grow and mature. This section should also be clarified to state that each individual state program is managed by the State SBDC Director within the organizational structure outlined in the SBDC Program proposal and that SBA district and regional personnel are responsible only for SBA oversight and representing SBA's interests in the partnership.
- 129.10 (b) The statement of the SBDC Program purposes is not sufficiently comprehensive. The purposes fail to note, for example, an advocacy function. P.L. 96-302 requires SBDCs to assume an advocacy role, including "providing assistance to small concerns with regulatory compliance" and "maintaining a working relationship with the financial and investment communities and small business groups." In addition, the section, as worded, implies that the SBDC Program potential is limited. It fails to note leveraged, cooperative and supporting relationships with the private sector, as well as other local, state, and Federal programs, aimed at providing services that will aid in the development, stabilization and expansion of small businesses. By suggesting that SBDCs provide only "direct" services to small businesses, the scope and potential of the SBDC Program is seriously understated. (See 129.18 for additional views pertaining to this issue.)
- 129.10 (c) (1) The final part of this section stating that "the final authority for the selection of SBDCs, the terms of the Cooperative Agreement, and the establishment of program policy rests with SBA" is inconsistent with

Ms. Johnnie Albertson
January 21, 1987
Page 10

current SBDC Program administration; fails to acknowledge the partnership relationship with a state or university under a Cooperative Agreement which determines priorities for the SBDC Program; and is too restrictive.

SBA and the SBDCs have collectively worked together to resolve problems as diverse as the on-site review process and develop appropriate evaluation tools and an SBA/SBDC Policy Manual. Each of these issues was cooperatively addressed and jointly resolved to the best possible level of satisfaction at the time. Policy matters such as these cannot be resolved otherwise since the Program operates under the auspices of Cooperative Agreements. Thus, the "final authority" for SBDC Program policy rests neither with SBA nor the SBDCs, but rather is subject to mutual agreement.

Further, Congress specifically directed that each SBDC and SBA shall have an equal role in determining the "terms of the Cooperative Agreement." Section 2(2) of P.L. 98-395 states:

"(2) The Small Business Development Center Program shall be under the general management and oversight of the Administration, but with recognition that a partnership exists under this section between the Administration and the applicant for the delivery of assistance to the small business community. Services shall be provided pursuant to a negotiated Cooperative Agreement with full participation of both parties."

When Congress decided Cooperative Agreements were to govern the relationship between SBA and a particular state, Congress intended both parties to the agreement to reach mutual understandings about the terms of the agreement.

- 129.10 (c)(2-3) It is inappropriate to include in a Federal regulation SBDC responsibility to foster productive relationships with SBI and SCORE. Such relationships must be the responsibility of both parties. If SBI and SCORE representatives are not cooperative, no regulation can direct the nature of these institutional and personal relationships. This section is gratuitous and can only lead to misunderstandings.
- (ii) The attempt to force membership of any group or organization on a board is inappropriate. Board membership should reflect the interests of the local small business community and should be comprised of those individuals best suited to meet the needs of the SBDC Program and no one else. Further, empirical evidence has already proven that in at least one state, having a SCORE representative on an Advisory Board has been a

Ms. Johnnie Albertson
January 21, 1987
Page 11

disrupting factor in meetings.

129.11 Definitions

This section conflicts in numerous and fundamental ways with established government wide requirements contained in OMB Circulars. It raises serious questions about SBA's intent, authority and purposes.

Where SBA's definitions track language in existing OMB Circulars or represent variations thereof, they create unnecessary confusion. If OMB definitions are to be used, then the appropriate definition should merely be incorporated by reference, but not quoted in its entirety. Where changes or totally new definitional requirements are proposed which do not apply presently to state or local governments or educational institutions under existing Circulars, such as the definition of "lobbying", SBA should provide a detailed explanation and justification as to why such a radical departure is warranted for the SBDC Program prior to revision of applicable OMB Circulars.

In the case where the SBDC statute requires a special definition of "cash match", SBA has departed in the regulation from specific language which has already been carefully formulated and approved in final form by the SBA's General Counsel, after protracted discussions with representatives of the SBDCs.

Other key definitions abrogate the premises of the Cooperative Agreement relationship between SBA and individual SBDCs. For example, the definition of "working days" violates both host institutional policies and OMB Circulars. And, the proposed definition of "conflict" poses a unilateral expansion of SBA's jurisdiction and an unwarranted intrusion into the operations of host institutions.

With major changes contemplated shortly in the applicable OMB Circulars, SBA must be particularly careful not to incorporate language which will soon be outdated.

- 129.11 (c) Cash match: The cash match definition in the proposed rule does not agree with the language in SBA notice 6000-122 issued on October 11, 1986. The language in that notice reflects the cash match definition already agreed to by SBA's General Counsel's Office. We are deeply concerned about the sudden effort to change unilaterally the definition of this very important term.

Ms. Johnnie Albertson
January 21, 1987
Page 12

- 129.11 (d) Conflict: The definition of "conflict" covering any programmatic disagreement or problem whether pre or post award regarding any matter not addressed in the Cooperative Agreement is too broad. The SBA has no authority over matters outside the Cooperative Agreement unless they are part of the application. Rather than expanding its jurisdiction, SBA should be diligently seeking ways to reduce its role as the SBDCs mature. SBA's role, barring reasons for suspending or terminating an SBDC already prescribed by OMB Circulars, should over time be reduced in scope as experience warrants greater trust and authority being vested in the SBDC.
- 129.11 (e) Direct costs: This section should reference the appropriate OMB Circulars for the recipient organization.
- (i) Full-time employee: This definition conflicts with the directive contained in Title II, Section (c)(2) of P.L. 96-302 requiring an SBDC to "make full use of other Federal and State government programs that are concerned with aiding small businesses." This definition precludes a full-time SBDC State Director from fulfilling his or her legal mandate to manage and utilize these other programs in concert with the SBDC Program to the benefit of the small business community.
- Similarly, the definition precludes the State Director from fulfilling his or her obligation under Title II, Section (d) of P.L. 96-302.
- Finally, this definition fails to recognize that State Directors are often required by their institutions to teach one course.
- 129.11 (j) Grant and Cooperative Agreement Disputes Resolution Committee: This committee, made up of only representatives from SBA, is inconsistent with the partnership nature of the program. (See 129.15(c) comment).
- 129.11 (m) Indirect Costs, (n) Indirect Match and (o) In-Kind Match: These terms are defined in the relevant OMB Circulars and simple reference should be made to the applicable provisions.
- 129.11 (r) Lobbying: This section should only reference the appropriate OMB Circular for the recipient organization.
- 129.11 (z) Satellite: This definition creates problems throughout the proposed regulation when reference is made to limitations on subcenters and satellites.
- 129.11 (dd) Subcenter director: There is no legal or policy basis for

Ms. Johnnie Albertson
January 21, 1987
Page 13

arbitrarily requiring a subcenter director to be full-time. P.L. 96-302 requires only a "full-time staff, including a staff director" of a state program. P.L. 98-395 likewise only requires that a State Director be a "full-time staff director." Nowhere is a full-time subcenter director mandated by law or suggested in the relevant legislative history.

- 129.11 (ee) Working days: This definition dramatizes the mischief created by the proposed regulation. Universities and state and local governmental agencies have established leave policies which may or may not be consistent with the proposed definition of "working days". OMB Circulars A-21 and A-87 state that employee compensation must be consistent with established institution policies. Additionally, fringe benefits negotiated and approved as part of the indirect cost rate by the cognizant Federal agency are based on established policies governing vacations, holidays, sick leave, pension plans and the like. SBA has no authority to depart from approved negotiated rates which have been established. Redefining "working days" to exclude all but "Federal holidays" would affect recipient entities compensation plans and place an unnecessary administrative burden on the recipient institutions.

129.14 **Application Procedure**

Application procedures for SBDCs have no place in a new Federal regulation. Existing OMB Circulars should apply and the cognizant agency should seek maximum flexibility to specify in its Program Announcement what at any given point in time it requires from an applicant. This section should be deleted in its entirety.

- 129.14 (a) General: The phrase "state or region" is ambiguous and too broad. Is a "region" an area within a state or is it a geographic area incorporating one or more states? Also P.L. 98-395 reads that, "certain states may require more than one funded SBDC in the state in order to insure that small businesses are given access to services," (Emphasis added.) SBA, responding to a question from the Senate Small Business Committee, identified only three states -- New York, California, and Texas -- where there might possibly be a need for more than one SBDC (see legislative history of P.L. 98-395). This section should specifically identify those three states. Further, Congress stipulated that the state's statewide plan was to be the guiding document in determining the number of SBDCs in a state. Thus, more than one SBDC should only be allowed if it is

Ms. Johnnie Albertson
January 21, 1987
Page 14

in compliance with such a plan. SBA has already ignored Congressional intent in the case of New York where the statewide plan called for only one SBDC, and not two as is presently the case.

- 129.14 (b) Contents-(1) General: This paragraph should end with a period after the words "Program Announcement". Paragraphs (i)-(vi) are only appropriate for inclusion in the Program Announcement and therefore should be deleted.

(2) Specific: (i)-(viii): Similarly, these subsections are only appropriate for inclusion in the Program Announcement and should be deleted. To assure operational flexibility and evolutionary change, rigid regulatory requirements should be avoided at all costs.

- 129.14 (c) Amendment: The reference to unidentified "authorized SBA officials" lacks clarity and should be refined. Further, it should be made clear that an SBDC can file an amendment at any time for SBA's review.

- 129.14 (d) Competing applications: This section should be reworded to state clearly that competing applications will not be accepted from other entities in states currently operating an SBDC unless a prior decision not to refund the current operating center has been made in accordance with established procedures. Thus, this section would apply only to competing applications from states which do not have operating SBDC Programs, are voluntarily terminating one type of SBDC sponsorship, or are not being refunded for cause.

(3) The reference at the end of this subsection to an existing SBDC being given the opportunity to match a better application presented by a new applicant is disruptive and should therefore be deleted. It is not the SBA's role to promote the submission of competing applications.

- 129.14 (e) Decisions Not to Refund Previous Program Participants: Subsections (1)-(5) outline a process which provides no avenue for arbitration by an independent board. An appeals process, including arbitration by an independent board, must be established in order for a final decision to be reached.

(5) This paragraph should make it clear that a subcenter of the ongoing organization may apply for designation as a recipient organization only after the refunding of the current SBDC has been denied.

- 129.14 (i) Unless Form SF912 is required for all recipients of government grants, contracts, and Cooperative Agreements, it should not be required of SBDC participants.

Ms. Johnnie Albertson
January 21, 1987
Page 15

- 129.14 (k) Conflicts resolution policy: The final resolution outlined in paragraph (3) establishes no time frame. This paragraph should say that "if there is no action on the part of SBA within 45 days, the resolution will be in favor of the SBDC." Further, in paragraph (3) the regional office should deal first with the SBDC Director, then with his or her supervisor.

129.15 Cooperative Agreement

This section adds nothing to the multiplicity of policy documents that already make abundantly clear what policies govern the SBDC Program. Worse, portions of this section are inconsistent with OMB Circulars and establish a one-sided dispute resolution process violating the statutorily mandated partnership nature of the Program.

- 129.15 (b) Revision to Cooperative Agreement: This section uses an example which violates the applicable OMB Circulars (A-102 and A-110) requirements for making budgetary changes. According to the Circulars, it is not necessary to notify the funding agency of a transfer which does not exceed 5% of the approved total budget. To institute a notification procedure in such cases would be extremely time consuming and serves no useful purpose since approval by SBA is not required by OMB Circulars. The unnecessary administrative burden imposed on SBDCs in notifying SBA of every single minute change in the budget should be avoided. SBA has seemingly ignored GAO and OMB reports in recent years commending universities in their management of research funds. These reports concluded that universities manage their external funds in an appropriate and efficient manner. With increased reliance on the states in recent years in administering Federal funds, we believe that states, like universities, are capable of administering the SBDC Program without the addition of new regulatory requirements.

SBA should recognize that micro-managing SBDCs is not good management as it leads to the inefficient and ineffective operation of programs. This example should be struck from the regulation.

In addition, a sign-off procedure is now in use and SBA gives no justification for reversing this current practice.

- 129.15 (c) Disputes: (2) (iii): The establishment of a Cooperative Agreement Disputes Resolution Committee composed solely of representatives from SBA

Ms. Johnnie Albertson
January 21, 1987
Page 16

ignores the partnership nature of the program. We recommend the establishment of a balanced Committee, which includes non-SBA representatives.

(2) (B) There is no provision stipulating what happens if a written decision is not made in 45 days. This subsection should be rewritten to provide that if a decision is not made in forty-five days, the SBDC's position is automatically upheld otherwise an issue could remain unresolved indefinitely.

129.16 **Suspension and Termination of the Cooperative Agreement**

Attachment "L" to OMB Circulars 102 and 110 prescribes uniform suspension and termination procedures for Cooperative Agreements. There is no reason for SBA to impose additional detailed requirements on SBDCs.

129.16 (b) Suspension: This subsection makes it possible to close down an SBDC operation before the final disposition of a termination for cause proceeding. This is a one-sided, arbitrary and capricious process and it should be deleted.

129.16 (c) Causes for termination: This section adds further confusion. Examples of wording which are ambiguous and troubling abound. For example

(1) "willful or material failure"; without illustrative examples these words lend themselves to unchecked bureaucratic mischief and abuse.

(2) "indicating a lack of business integrity or honesty". Again, what is meant? To describe this language as overly broad is an understatement.

(3) "conviction of or civil judgment against the SBDC Director, any subcenter Director or any key SBDC employee..." It is unclear why a program should be shut down because of a single individual's misconduct, nor is it clear what a "civil judgment" encompasses. Does a divorce decree or a finding against an SBDC employee in a tort action give cause for shutting down an SBDC? This terminology is therefore too broad to be used as a cause for termination.

(4) Choosing two examples of conflict of interest in subsections 4(i) and 4(ii) also raises more questions than it answers. The conflict of interest issue should either be left open to local determination or a comprehensive conflict of interest policy should be established.

(4)(i) An SBDC should be prohibited from serving only those small companies in which the SBDC, any subcenter or any SBDC employee has a

Ms. Johnnie Albertson
January 21, 1987
Page 17

controlling financial interest. This prohibition should not be applied to a minority financial interest.

(6) This language should be deleted as many subcenter directors are not full-time. The size of many of the SBDC programs and the current level of Federal funding makes it impossible for each subcenter to have a full-time director. As stated earlier, full-time subcenter directors is not a requirement of law and therefore this provision can only serve to deny needed services to small businesses as existing subcenters will have to be closed.

129.16 (d) Procedures: (2) Cure notice (i): This section is permissive and therefore is of no benefit to the management of an SBDC. It says that the Deputy Associate Administrator for Business Development/SBDCs "may request" the Grants Management Branch Chief to send a cure notice. It is absolutely essential that this language be amended to require that a cure notice be sent as the next section addresses the termination of the Cooperative Agreement if the SBDC does not respond to such a cure notice. Subsection (ii) provides that SBA may terminate the Cooperative Agreement for "convenience" or can initiate termination for cause proceedings. It would seem that if the option is available to terminate for convenience, there would be no incentive to initiate the "termination for cause" proceedings which would be more time consuming for the agency. Therefore, reference to termination for "convenience" should be deleted.

(6) Notice of decision: (iv) The Cooperative Agreement can be terminated as stated in subsection (6)(iii), but SBA cannot require termination of an SBDC per se. Instead, SBA may merely terminate Federal funding of that particular SBDC Program.

129.16 (f) Effect of termination: (1) Again, SBA can discontinue Federal funding, but the agency cannot legally require activities not funded by SBA to be discontinued.

129.17 **Small Business Development Centers (SBDCs)**

This entire section should be deleted as the composition and management of an SBDC does not lend itself to the rigidity of regulation. These matters already are thoroughly and adequately addressed by statute and in SBA's annual Program Announcement.

129.17 (a) Area of Service and Location of SBDCs: (1) As a matter of policy,

Ms. Johnnie Albertson
January 21, 1987
Page 18

this section should not permit the establishment of more than one SBDC in a single state except those states -- New York, California, and Texas -- where multiple SBDCs have been previously contemplated and identified in response to Congressional inquiries.

(ii) This language violates the statutory language of P.L. 98-395 and the partnership aspect of the program. The statewide plan, as approved by SBA, is to determine the area to be served.

(3) "Satellites" are not specifically covered in Cooperative Agreements. This proposal will cause needless bureaucratic delay and is not in the interest of the small business community.

129.17 (b) Staff and access requirements: This entire subsection does not belong in regulation as it either restates language in the statute or Program Announcement. In addition, sections (b)(7), (b)(8), and (b)(9) are in conflict with OMB Circulars as they relate to salary charge methods and overhead and fringe allowances which are based on pools agreed upon by cognizant agencies, and which recognize vacations, holidays, retirement benefits, sick days, and so forth, as part of the negotiated rate. Section (b)(7) also is highly irregular as these assurances are all part of the time and effort reports required by the OMB Circulars. In subsection (b)(8) financial resources of virtually all SBDCs are insufficient for operating full-time satellites.

129.17 (c) Resources: (3) How are such programs to be "kept separate in funding, recordkeeping and client awareness." What does "client awareness" mean?

4(iii) The sentence beginning "The SBDC Director must ensure..." should be deleted. It is inconsistent with Section (c)(3). Further, it is impossible for the SBDC Director to play policeman and provide the guarantee SBA seeks. The SBDC Director should endeavor to make certain SBDC services do not duplicate other services.

129.17 (d) Services: (1) The language should be revised to direct the SBDC to endeavor not to duplicate or replace existing services. It is impossible for an SBDC to provide an absolute guarantee that its services are not being replicated somewhere in the state.

(4)(ii)(A) As worded, this subsection could create an unworkable situation and destroy the flexibility of the SBDC to respond to needs as they are identified and to take advantage of opportunities to cosponsor

Ms. Johnnie Albertson
January 21, 1987
Page 19

training with other groups or entities. It should be eliminated, or at the very minimum, be changed to permit SBA to make suggestions in developing SBDC training programs, but it should not be mandatory that all training be jointly planned.

(4)(ii)(B) The word "prominently" should be defined or deleted.

(4)(vi)(B) The word "comprehensive" should be defined or deleted.

(5) To require SBDCs currently at their funding cap to "upgrade and modify" is unacceptable as funding obviously does not permit this.

- 129.17 (e) Research: A requirement that no research shall be undertaken unless a review is made of "SBDC national research projects" is impossible to implement. It is also impossible to project eighteen months in advance research projects needed by the small businesses to be served and to project what projects will be undertaken. Further, neither the term "research" nor the phrase "SBDC national research projects" is defined. Even if "national research projects" were defined, how is an SBDC to become aware of such projects so that the SBDC may undertake the required review? Finally, some states, Iowa for example, require SBDCs to do research. The Federal partner should not prohibit SBDC research required by the state partner.

129.18 **SBDC Clients**

This section violates the partnership aspect of the program in that it gives SBA's Central Office and regional and district offices unilateral authority to set priorities for the "method and the delivery of assistance to SBDC clients" regardless of whether such needs correspond to those of the local small business community, the state and local governments and the SBDC host institution or agency. SBDCs are also required to provide assistance to "target groups" even though there may not be sufficient resources to adequately service both the targetted groups and eligible clients who independently become aware of possible SBDC assistance.

- 129.18 (a) Eligibility: The SBDC Program was designed to not only help individual small businesses, but there is a statutory mandate to work with other entities in assisting smaller firms with such matters as technology transfer, state and Federal regulatory compliance, and problem solving in the financial, marketing, personnel, manufacturing and other areas " needed by small business for growth and expansion, innovation, increased productivity and management improvement..." Thus, a requirement that only

Ms. Johnnie Albertson
January 21, 1987
Page 20

small businesses as defined by the Small Business Act receive assistance is inconsistent with the statute as such assistance may be rendered to other governmental or non-profit organizations whose principal mission is to help the small business sector. If this stipulation were to be adopted, it would force the dismantling of a significant portion of many SBDC operations which leverage their resources by working with such groups and organizations.

This section also fails to recognize that SBDCs for ten years have developed guidelines and exercised good judgment in determining whether an individual firm is a small business. To impose a strict size eligibility test would require the SBDC to cope with extremely complicated size standards which have given rise to numerous interpretative controversies. SBA has created a unit that does nothing but try to interpret and apply these size standards to specific situations. The process is extremely cumbersome and time consuming. We strongly recommend that SBA not subject the SBDC Program to this administrative quagmire.

- 129.18 (b) Priorities of assistance delivery: This section violates the concept of a partnership under Cooperative Agreements. The Program was not designed to simply carry out the mandates of the SBA; it was established to serve the small business community within each state. SBA again flaunts Congressional intent by arbitrarily placing itself in control and giving the Central Office authority to "set national priorities for the method and delivery of assistance to SBDC clients generally and for individual SBDCs through the annual Program Announcement and other issuances of the Central Office." (Emphasis added.) For the same reasons, the "region" -- presumably SBA regional offices -- and the district offices, should not be allowed to dictate priorities. The Cooperative Agreement signed by SBA and each SBDC means that this Program is a partnership with neither party dictating terms to the other.

129.19 **Advisory Boards**

There is no justification nor need for Advisory Boards to be covered by a Federal regulation.

- 129.19 (b) State/Regional SBDC Advisory Boards: (2) It is inappropriate to suggest that SCORE, ACE and/or SBI representatives serve on an Advisory Board. Board membership should be comprised of those qualified persons who are best suited to advise, counsel, and assist in the growth and

Ms. Johnnie Albertson
January 21, 1987
Page 21

development of the SBDC Program. Again, each state has its own unique needs which do not lend themselves to conformity with nationally dictated standards. Also, there should be a provision to allow SBDCs to use existing state small business advisory boards whose compositions have already been determined according to the unique needs of each state.

129.20 **Financial Aspects Of The Program**

Financial aspects of Cooperative Agreements are covered in the appropriate OMB Circulars. The Association finds no justification for departing from those Circulars. Further, the agency should develop and live by its own timetables. We strongly object to the inclusion of this section in any regulation.

- 129.20 (a) Budgeting: (1) Budget Proposal: (i-ii) Both subsections should be eliminated as they are a regurgitation of a proposal submission process which works only marginally now. To make this process part of the regulation would prevent its further refinement and make it impossible to develop a system which would be most appropriate for the SBDC Program. The system described and mandated herein was developed when the SBDC Program was much smaller and less mature than it is today. It is thus inappropriate to specify the process in regulation and it is particularly offensive to codify dates and time periods which the agency cannot now meet and which currently are in urgent need of revision.

(iii) The issuance of a letter by the Office of Procurement and Grants Management advising that funding will be continued should not be permissive, but should be mandatory. The word "may" should therefore be changed to "shall." Such a required letter should be received by the SBDC at least 30 days (not the stipulated two weeks) prior to the close of the current budget period. An SBDC cannot commit its own matching resources for the next operating period without timely assurance of continued Federal funding. This is but another example of SBA's one-sided approach to the partnership nature of the SBDC Program in that it assumes continued state funding of an SBDC in the absence of Federal match funds.

(iv) A letter of continuation should be issued (change "may" to "shall") when refunding of an SBDC is anticipated. Again, the issue should be unequivocally resolved by requiring written notice. The stipulation that the letter shall lapse within 120 days should be deleted since delays which exceed 120 days have frequently occurred in the past, and if there is

Ms. Johnnie Albertson
January 21, 1987
Page 22

a conflict or a dispute procedure underway, funding should continue until the issue is finally resolved. More specifically, section (iii) and this section are unique to SBA. It is very risky for both SBA and the recipient institution to agree to accept a letter of continuation with no formal agreement in place. For example, the absence of a formal agreement means no provision is provided for an SBDC to undertake normal business operations such as invoicing or hiring for new positions. It is ironic that SBA includes those procedures now in place in the proposed regulation, yet publically admits its inability to produce Notice of Awards on a timely basis.

- 129.20 General Requirements: (A)-(C): These subsections cover operational items already addressed in each year's Program Announcement. They should be deleted from the regulation.

(D) This subsection is without legal precedent or basis. It is contrary to the statute establishing SBDCs and is inconsistent with requirements of OMB Circulars A-21 and A-87. Where, for example, costs of membership in professional associations would be allowable under the applicable Circulars for educational institutions and state or local governmental agencies the proposed regulation would impose serious limitations. Material departures from established government policies can only be construed as an effort to hamper the legitimate activities of institutions participating in the SBDC Program. One of the critical roles SBDCs must perform is to work closely with small business organizations. This Congressional mandate cannot be realized with arbitrary limitations of this kind. SBA should avoid discriminating against SBDCs by incorporating by reference a simple and accepted policy on associations dues. As stated in OMB Circular A-21: Costs of the institution's membership is civic, business, technical, and professional organizations are allowable.

- 129.20 (a)(c) Transfer of Funds. The applicable OMB Circulars provide maximums relating to out-of-state travel and capital equipment without agency approval. There is no reason for SBA to be more restrictive.

(4) Carryover of Funds: (iv) This subsection does not address carrying forward unobligated, unexpended Federal funds, which is allowable under subsection (i) of this subsection (4). Such carryover funds would first have to be rolled over into the following year's award and into the letter of credit before the unexpended, Federal dollars are deducted. What

Ms. Johnnie Albertson
January 21, 1987
Page 23

is meant by the use of the word "undigested" Federal dollars? The term should be either defined or deleted.

- 129.20 (b) Receipts: (1) Grants--Amount of Grant. (ii) The reference to \$65,000,000 should be removed and replaced with the words "pro rata share of the formula in the law." The \$65,000,000 amount may be changed and therefore should not be referenced in the regulations.

The entire section under (b) Receipts-(1) Grants--Amount of Grant and (2) Matching funds (i)-(ii) is a complete repetition of the statute. It is therefore unnecessary to reiterate all this information in the proposed regulation.

(iii) This subsection is in disagreement with the cash match definitional statement already prepared and distributed by SBA (SBA Notice 6000-122 effective October 11, 1986) and therefore should be made to conform to that notice. Further, the language must be changed to reflect the appropriation process in many states. Specifically, the last sentence should read "...must verify that such funds have been appropriated prior to expenditure of funds in the Cooperative Agreement."

- 129.20 (b)(v)(A) Restrictions in Overmatched Amounts. Although SBDCs are encouraged to furnish overmatch in this subsection, such amounts become part of the SBDC's Program budget for that year. Such a restriction provides a major disincentive for reporting overmatch because it makes those state resources subject to SBA control. Those state resources are outside the purview and scope of SBA's authority.

(v)(C) This section seems to be an unnecessary statement when section (a)(4)(ii) already states that "an SBDC may carry over unobligated, unexpended matching funds from one budget period to the next..." The ability to carry over unspent overmatch also is addressed in section (b)(2)(v)(B). However, the second part of (C) states that "verified unspent overmatched dollars may be used as a credit to offset an audit disallowance..." (Emphasis added). It should be allowable to use verified spent overmatch to offset confirmed audit disallowances applicable to the budget period in which the overmatch existed.

(vi)(A)-(E): Impermissible Sources of Matching Contributions. This list of impermissible sources of matching contributions should be deleted and replaced by referencing the appropriate sections in OMB Circulars. This is an arbitrary list which is neither complete nor accurate and

Ms. Johnnie Albertson
January 21, 1987
Page 24

creates even more confusion in the already confusing area of matching contributions. Part (E) is particularly difficult to interpret as this section has expanded on what is in both the statute and OMB Circulars. The reference to the inability to use "SBA supported companies or corporations..." is not acceptable since it is unknown who these companies or corporations are.

- 129.20 (b)(4) Program Income: (i)-(iv) This entire section should be deleted and replaced by referencing OMB Circulars. Subsection (ii) of part (4) already addresses the appropriate OMB Circulars and states that SBDC program income is subject to the provisions contained in these Circulars.
- 129.20 (b)(5) Fees: This section should be deleted. Charging fees for counseling services raises a host of other issues which create problems for the SBDCs and, most importantly, their small business clients. There has been no analysis of what the impact of charging fees would be either programmatically, administratively, or economically on either small businesses or the SBDCs; thus, it is inappropriate to address this issue at this time in a Federal regulation.

Further, this section conflicts with Congressional intent. Senate Report 98-309 states with respect to SBDCs charging fees for counseling:

"However, the Committee would be concerned with any general policy of charging small business concerns a fee for one-on-one counseling. Such a fee structure could tend to increase the likelihood of direct competition between the SBDC and the for-profit sector."

SBDCs have attempted to avoid competing with the private sector as they strongly believe it to be an inappropriate role for government. The Association is surprised SBA would condone such competition with commercial providers of services. In doing so, SBA is repudiating a top recommendation (No. 3 overall) of the White House Conference on Small Business.

- 129.20 (c) Expenses: The applicable OMB Circulars (A-21 and A-87) establishing cost principles should apply. No further requirements by SBA are warranted. Each specific element of cost should be allowed or disallowed under generally applicable government policies contained in the relevant OMB Circulars. Substantial deviations from established Federal practices and policies contained in this section relating to salaries, travel, dues, and lobbying can only be described as arbitrary and legally questionable.

Ms. Johnnie Albertson
January 21, 1987
Page 25

129.21 **Evaluation of SBDC Program**

The subject of the SBDC program evaluation is not appropriate for regulation. An evaluation process should be dynamic and fluid so it responds to the needs of the program and the small business community. As the SBDC network expands and changes, the evaluation procedures should also change. The evaluation processes outlined in this section have evolved over many years and should not, at this point, be committed to Federal regulation. As forms change and the Management Information System matures, evaluation needs and requirements will undergo further discussion and refinement.

- 129.21 (b) Client control records: This is an area which should be governed by policy and Program Announcements and not regulation. The types of records needed will vary and will be subject to change as the SBDC Program continues to mature.

(b) (6) Under no circumstances should records of SBDC clients who are also SBA clients be made available for duplication by SBA personnel. All information disclosed by a small business concern to an SBDC is done on the basis that such information will be held in absolute confidence and not disclosed to any other person other than an SBDC staff member or individual having an agency relationship with the SBDC, and then only in instances where access to sensitive company information is needed so appropriate services or advice and counsel can be provided to the client. Allowing SBA to have access to such records breaches the trust placed in the SBDC by not only that particular small business, but all existing and prospective clients as they rightfully can no longer assume that confidential and proprietary information will not be disclosed. This perception will seriously undermine the effectiveness of the SBDC because it is essential that it have access to such information if it is to be of genuine assistance.

- 129.21 (c) Performance reports: This subsection is also not appropriate for regulation. What each SBDC must provide in performance reports will depend a great deal on how the SBDC Program evolves. This can be fully covered each year in a more dynamic document such as the annual Program Announcement. A perfect example of the problem of putting this information in regulations is demonstrated in subsection (c)(2)(i) since this subsection refers to short-term and in-depth counseling, a distinction

Ms. Johnnie Albertson
January 21, 1987
Page 26

which recently has been removed by SBA. (SBA notice 600-137 effective October 23, 1986.)

- 129.21 (e) Audits and investigations: (1) General-(i) Access. Before enumerating the records (A-G) that should be available for examination in an audit, in parentheses it says the list is "subject to OMB approval." It is unclear how this affects the proposed regulation. For example, does OMB still have to give additional approval or is the list binding?
- (2) Audits: (iii). This subsection is contradictory and it is unclear when the audits will take place. The subsection addresses the single audit of a recipient organization pursuant to OMB Circulars A-102 and A-110. Such single audits are supposedly a requirement and not an option; therefore, the SBDC Program should be audited according to the single audit procedure and not according to what is outlined in this proposed regulation. It is even more contradictory to have an agreement subject to the administrative constraints of a particular OMB Circular, A-110, which mandates its own audits, and then have SBA mandate a separate audit. A Cooperative Agreement falls under A-110 and its audit requirements and those requirements and results are sufficient. In section (iii) who would be financially responsible for such an audit? No funds are budgeted to enable an SBDC to go back several years and perform an audit. This section should be clarified or deleted.
- (v) The implication is that annual audits will be required for all SBDCs that receive \$200,000 or more in Federal funding. Since the statute requires all SBDCs to receive at least \$200,000, section (v) is not consistent with section (iii).
- (3) Investigations: It is unclear how SBA can determine when a person is "about to engage in an act or practice which would constitute a violation of the Small Business Act." This statement should be deleted.
- (f) On-site reviews: This entire on-site review section should be deleted as it is inappropriate for regulation. The on-site review process is dynamic and will only be stifled by the proposed regulation.

CONCLUSION

In summary, the Association of Small Business Development Centers believes that the proposed regulation would seriously interfere with the effective implementation

Ms. Johnnie Albertson
January 21, 1987
Page 27

of the SBDC Program and as a consequence hurts the small businesses the SBDC Program is intended to serve. It fails to reflect applicable federal law and their legislative intent; it abrogates the relationship between the Federal government and universities, the Federal government and the states, and the Federal government and the private sector which is well-established under existing OMB Circulars. The proposed regulation is internally inconsistent; it negates existing SBA policies and guidelines governing the SBDC Program which have been carefully negotiated and agreed to by SBA and the SBDCs; and, it violates fundamental principles of good program management which should encourage diversity, flexibility, innovation, decentralization and partnership. For each and all of the above reasons, we strongly urge that SBA withdraw this proposed regulation.

Respectfully,



G. Thomas Cator
Executive Director

STATEMENT OF MATHEW COFFEY
NATIONAL TOOLING AND MACHINING ASSOCIATION
BEFORE THE
SENATE COMMITTEE ON SMALL BUSINESS
FEBRUARY 25, 1987

I. INTRODUCTION

I am here today on behalf of the National Tooling and Machining Association.

Our industry has two distinctive characteristics. First, it is the backbone of all American manufacturing. Anything that is mass produced by machinery -- whether toasters, pens or silverware, rocket parts, car engines or computer keyboards -- is shaped by tools, dies, molds, machining and special machines. Without our "products", there can be no mass production. It was the creative genius of our predecessors in the 19th century that gave America its industrial might and pre-eminence. Today, our members are one of the nation's most technically innovative and advanced industries -- at the cutting edge of high-technology. And if America is to continue to have a domestic manufacturing capacity of any kind in the next century, then we must have the ability to create the tools, dies, molds, machining and special machines that allow our factories to work. There is no other service or product that is so essential to every aspect of American industry.

The second distinctive characteristic of our Association, and one that is particularly relevant to this Committee's deliberations, is that we represent the classic American "small business" industry:

- o 12,000 separate companies
- o 80% under 20 employees

- o typical firm has 8 or 9 skilled craftsmen, with 1 or 2 support clericals
- o virtually entirely owner-operated -- a truly entrepreneurial industry.

There is probably no other manufacturing industry in America that has this "small business" profile -- a profile usually found in local retail and service businesses (cleaners, grocers, drug stores) not in manufacturing and production.

Our industry is so highly fragmented because of the unusual nature of our manufacturing process:

- o customized - almost every job is a custom assignment to meet a special need, not susceptible to mass production;
- o industry specific - while heavily concentrated in such fields as automotive, defense and aerospace, our companies work for every industry and every American manufacturer -- collectively we cover the whole economy, but on an individual basis most of our firms tend to focus on niches in particular industries;
- o creative - our work often requires the development of innovative designs and new production techniques which involve extensive research and testing;
- o skilled - our workers are highly skilled craftsmen, trained in engineering, mathematics and technical design;
- o precision - we produce extremely complex close-tolerance products, regularly meeting standards of 1/10,000th of an inch -- equivalent to 1/20 the width of a human hair; and
- o service - while we produce tools, dies, molds, and

precision metal parts, our customers are themselves manufacturers and we must respond to their frequently changing technical requirements.

Because of these characteristics, our business is not conducive to large-scale operations and remote management and will remain small-scale and entrepreneurial.

II. COMPETITIVE and SELF-RELIANT

Because of the small size of our firms and the customized nature of our work, this has always been an extremely competitive industry. Our members compete against each other and against foreign firms for each piece of business. As a result, there is constant pressure for quality work and cost effective innovation that continually selects the best-managed and most skillful firms for survival.

Our members are consequently independent, determined and self-reliant. They not only run every aspect of their own businesses, but they take personal responsibility for quality and service and for the economics of their firm. They have no one else to lean on, to turn to or to blame. They are realists who must deal with changing economics and new technologies. And they accept the burden of adapting to change if they are to remain competitive and survive.

III. THE CHALLENGE

Our industry is in the process of massive changes, which challenge the innovativeness, management skills, and financial resources of NTMA's membership. The members are challenged to change their process technologies, which have

undergone rapid conversion from old-line mechanical controls to computer-driven lasers. They are challenged to upgrade their work force to fit with the new capital and technologies. They are challenged to adapt to the demands of their customers as they are undergoing rapid technological change and a restructuring in the way they do business -- new processes, new materials, finer tolerances and specifications, and new business locations.

A final set of challenges comes from the threat of international competition. While there has always been some foreign competition in selected areas, over the past few years there has been a significant increase in direct foreign competition. We have seen the competitive environment change rapidly and substantially because of three major factors:

- o the movement off-shore of major U.S. manufacturing facilities with the corresponding purchase off-shore of the supporting tools, dies and molds;
- o the development of increasingly high-level technical expertise and skills by foreign firms (largely as a result of past U.S. policies to strengthen these foreign economies); and
- o the favorable economics of foreign firms based on such factors as government subsidies, lower cost of capital, lower employee benefit costs and fewer mandated costs imposed by government regulation.

While our members welcome free and open competition, these factors have significantly changed certain segments of our industry. They have placed unrealistic capital burdens on our small, owner-operated businesses and have exposed them

to what we believe to be various unfair trade practices by heavily subsidized foreign competitors. Our industry now appears to be under intense attack from many corners of the globe -- ball bearings from Japan, dies from Taiwan, molds from Canada and Portugal, and so on. Because we are so fragmented, dealing in thousands of narrow niches, our members are vulnerable to highly targeted attacks. And that is just what is happening -- with our companies being picked off on many narrow fronts simultaneously. Because these are such specialized areas, it is difficult to get an aggregate picture of the magnitude of this foreign assault and to monitor its growth and success. But it is happening every day. And because our members are each so small, they have little to fall back on if their major area of expertise and client base is undermined.

IV. REMEDIES

We believe that some of this foreign competition is based on unfair and illegal trade practices. But we have found that the trade laws were designed to protect large American industries which can readily identify damage and can afford to seek remedies -- and to sustain significant losses while relief is sought. Existing trade remedies are not really accessible to our members. Indeed, the cost of a major trade case could be as much as \$500,000 -- exceeding the liquidation value of most of our members.

The 1984 Trade Act for the first time took cognizance of this problem and included several provisions to aid small

business. But the reality is that these steps have accomplished little and small businesses with legitimate grievances are still effectively precluded from relief.

We urge this Committee to see that the 1987 Trade Act truly makes relief available to small businesses such as ours. Among the proposals that would accomplish this objective are:

- o Limitations on diversionary dumping with downstream product monitoring to prevent evasion of U.S. dumping and subsidy laws.
- o Establish clearer statutory guide lines on upstream subsidy investigation.
- o Establishment of a private right of action so that damages get paid to the injured company, not the government.
- o Creation of a Small Business Trade Advocate Office in the Commerce Department with extensive authority not only to assist in bringing unfair trade cases, but to initiate cases and fact-finding on behalf of small businesses;
- o Consideration of small business factors, such as the unavailability of data, size of companies and their ability to survive, by the ITC;
- o Cost-sharing by the government in filing and prosecuting cases by small businesses in need of assistance;
- o Simplifying ITC preliminary injury determinations to eliminate costly duplication of the exhaustive investigation that is part of the final determination stage;
- o initiating fast track investigations to produce quicker and less-costly relief; and

- o A time limit be created for Section 232 cases involving a national security determination.

This Committee should ensure that our trade remedies can function to provide meaningful relief to small manufacturers if they are subjected to unfair foreign competition in their basic business.

V. REMEDIES - LIMITATIONS

While it is important that small business have equal access to the full range of trade remedies, use of the remedies is unlikely to be of great benefit to our members. For remedies come too late -- well after the fact of unfair damage. A small firm that has developed expertise, equipment and relationships in a particular niche over decades can see its entire business fail if it loses a few major contracts through unfair competition. It takes months, even years, to develop the capacity to handle some of our complex jobs involving close tolerances and extensive quality controls. Just to maintain demanding quality control systems for sophisticated defense work costs tens of thousands of dollars. Unlike large firms that can spread its costs over many customers and product lines, our members with a narrow client and specialty base can not afford to maintain these systems on stand-by; once a contract is lost, the systems and controls must be dismantled and are unlikely to be recreated.

The fragmented structure and custom-nature of our industry also makes it difficult to use traditional trade remedies since we are generally unable to collect data on a

consistent, sustained basis -- or to aggregate data in a meaningful way. The data currently available from the government fails to depict adequately the activity of our industry and the impact of foreign competitors. A more detailed study and data collection effort is essential. We plan to submit proposals along these lines to the Department of Commerce and the Congress in the next few weeks.

More important than remedies which come after the damage is inflicted, we want to strengthen our industry so that it can continue to function and thrive as a vital part of America's industrial foundation.

VI. INDUSTRY INCENTIVES

As I stated in my opening, the tooling and machining business is the backbone of all American industry. It is essential if we are to continue to have any domestic manufacturing capabilities whatsoever in the years ahead. And it is particularly critical to our ability as a nation to continue to do research and development in such critical fields as space, high technology and defense.

Under current law, our industry not only receives no special incentives, but even finds it difficult to benefit from the widely-used federal support programs that were clearly designed for larger, traditional manufacturing firms. This particularly applies to existing job training and tax incentive provisions.

The tool, die, precision machining and special machine industry is probably unique in the extent to which its production efforts are customized. But the tax code provisions designed to stimulate research and development by major industrial firms are based on a mass production model, where R&D activities are easily separable from ongoing production. Our firms operate totally differently; R&D is both a major part of their activities and usually integrated fully into their production work. The process by which one of our firms creates a customized tool, die, mold or special machine to meet the complex needs of a customer is in effect all "R&D". We tend to manufacture 3 or 5 or 10 custom-crafted products as the result of our work, not millions of mass produced pieces.

We urge that steps be taken to adjust existing incentive programs, designed with large-scale manufacturers in mind, to meet the needs of our small businesses. And that additional carefully targeted incentives also be provided to deal with the unique characteristics of the tool, die and precision machining industry. These provisions should deal with particular problems with modern equipment, skilled manpower and R&D procedures.

A. Equipment

To remain competitive, our members must invest in sophisticated new equipment, usually computer controlled, that can satisfy exacting performance

standards and ensure cost-effective operations. This type of equipment is enormously expensive -- say \$250,000 for one machine. That may be relatively insignificant for General Motors or IBM, but it's an enormous burden and exposure for our small owner-operators. Without the most modern equipment, our shops will not remain competitive in terms of precision or cost structure.

These machines often have a surprisingly short life cycle because they are either worn out and lose their incredible precision or they become outmoded. To deal with these problems, we urge enactment of:

- o a special investment tax credit to assist small businesses that lack a significant capital base in obtaining expensive high technology and computer-controlled equipment; and
- o adoption of a revised depreciation schedule for computer-controlled machinery which accurately reflects the short life cycle of this equipment, which is much shorter than the seven years now allowed.

B. Manpower

The Congress appears to be focusing on increased programs to retrain workers who lose their jobs through foreign competition. That, of course, is critical.

But why wait until workers lose their jobs? In our industry we see many highly skilled craftsmen who lack the new expertise, particularly with computers,

that will be needed in the years ahead. If these workers don't gain such skills, many will lose their jobs in the next few years.

We urge that Congress provide adequate funds for retraining current workers through tuition grants and other support to gain the skills needed for their future survival in a changing technological work environment.

We also believe that there has been a built-in bias against small business in existing manpower programs. This is largely because of the ability of large corporations with a staff of personnel professionals to participate more actively in these programs to meet their regular on-going needs for large numbers of new employees. We have neither full-time personnel professionals nor ongoing hiring demands for each company. But our industry needs new talent -- serious, motivated people with solid technical skills who can survive the traditional four year learning period needed to master our basic skills, and benefit thereafter from the excellent compensation available for our master craftsmen.

All major manpower programs, such as the JTPA, should contain a requirement that special attention be given to the needs of small businesses. That would help us satisfy our critical need for new talent.

C. R&D

Much of what our firms do is R&D. Indeed, many of our firms are almost entirely engaged in R&D activities. We urge that the Tax Code be modified to have the R&D credit shaped more clearly to apply to the activities of industries like ours that are involved in customized production to avoid the anomaly that one of the most R&D-intensive American industries finds it difficult to benefit fully from the Tax Code's R&D incentives.

America's major problem has traditionally been with the commercialization of R&D -- applying to the marketplace the work we have so successfully done in basic research. Again and again we have seen other countries take our basic research and use it in practice to beat our own industries. Virtually everything our industry does is applied R&D -- the kind of practical sophistication that American business needs to encourage. Steps must be taken to ensure that the tax law is targeted to encourage and support this vital activity.

VII. COMPETITION IN CONTRACTING

The 1984 Competition in Contracting Act was designed to help expand the opportunity for small business to participate in defense and other procurement. Some limited progress has been made. The progress in spare parts procurement, however, has not lived up to our hopes and expectations. Our best estimate is that only about 10% of spare parts are being procured through formally advertised sealed bids.

We recognize that competition has been increasing in areas involving architectural, computer software and other service-type activities. We do not understand why spare parts have not been more aggressively competed. We suggest that the Committee investigate mandating the levels of competition in procurement by SIC category. Perhaps through this device, we can increase the competition in spare parts procurement.

We have actively pursued simplification of federal procurement procedures. We believe that the 1986 White House Conference on Small Business Issues recommendations should be pursued.

VIII. MANDATED BENEFITS

One of the negatives in our ability to compete has been the mandating of employee benefits by the Congress. Clearly, congressionally mandated benefits increase costs and are not imposed on our direct foreign competitors. This obviously places this Committee and business owners in an awkward position. We are caught between a desire to furnish first class benefits and the need to lower the cost of production. We expect the 100th Congress will generate many bills such as S.79, the High Risk Occupational Disease Notification Act. We would hope that this Committee will monitor all of these types of legislation to determine the impact on small business.

IX. SELF-HELP

Above all, we are committed to self-help as an industry to ensure that our members remain competitive. This means far greater emphasis by our companies on their own, and through industry-sponsored programs that focus on:

- o quality -- the hallmark of our business; that requires the highest craftsmanship and rigorous monitoring and quality control systems;
- o productivity -- ensuring that the most sophisticated and cost-effective equipment and processes are being used; and
- o service -- providing our customers with the most responsive, speediest service possible.

Our Association already has successful programs in these areas but we recognize that more must be done and we will be mounting these efforts in the year ahead.

Our members are confident that they can remain fully competitive in terms of quality and service -- and that with appropriate incentives, they can significantly narrow any cost differentials with foreign competitors. This is a proud group of American craftsmen who have been critical to our industrial might in the past and who look to continuing to play that role for America in the future.

FOREIGN LABOR COST COMPONENTS IN RELATION TO U.S. PRODUCERS
(Based on U.S. dollar values derived from average annual exchange rates.)

COUNTRY	1970	1975	1980	1981	1982	1983	1984
Average Hourly Compensation							
France	41	72	92	75	68	63	56
West Germany	56	97	125	97	90	85	75
Italy	42	73	81	68	63	62	58
Japan	24	48	57	57	49	50	50
Korea	NA	6	11	10	10	10	10
United Kingdom	36	51	75	65	58	51	46
United States	100	100	100	100	100	100	100
Output per Hour							
France	65	70	82	81	85	86	87
West Germany	66	71	79	78	79	79	78
Italy	56	60	70	70	71	68	69
Japan	44	52	72	74	79	79	84
Korea	NA	15	17	18	18	17	18
United Kingdom	41	43	42	43	44	45	44
United States	100	100	100	100	100	100	100
Unit Labor Costs							
France	63	103	112	92	80	74	65
West Germany	85	136	157	123	114	107	95
Italy	75	123	115	96	89	91	84
Japan	53	92	79	77	62	63	60
Korea	NA	39	63	57	59	60	56
United Kingdom	86	120	177	151	132	115	105
United States	100	100	100	100	100	100	100

NOTE: NA = Not Available

SOURCE: Data Resources, Inc., 1985.

AVERAGE WEIGHTED COST OF CAPITAL TO INDUSTRY, 1971-1981
(in percent)

COUNTRY	1971	1976	1981
France	8.5	9.4	14.3
West Germany	6.9	6.6	9.5
Japan	7.3	8.9	9.2
United States	10.0	11.3	16.6

SOURCE: U.S. Department of Commerce, "Historical Comparison of Cost of Capital," April, 1983.

COFPAES
COMMITTEE ON
FEDERAL PROCUREMENT OF
ARCHITECTURAL/ENGINEERING
SERVICES



American Congress on Surveying & Mapping
American Consulting Engineers Council
American Institute of Architects
American Society of Civil Engineers
ARTBA Planning & Design Division
National Society of Professional Engineers

STATEMENT

By

COMMITTEE ON FEDERAL PROCUREMENT
OF ARCHITECTURAL/ENGINEERING SERVICES

To

SENATE COMMITTEE ON SMALL BUSINESS

Concerning

SMALL BUSINESS PROCUREMENT ISSUES OF CONCERN
TO THE ARCHITECTURAL, ENGINEERING AND SURVEYING PROFESSIONS

February 25, 1987

Mr. Chairman, my name is Arthur A. DeFraites, Jr. I am a consulting engineer from Houma, Louisiana and Chairman of the Committee on Federal Procurement of Architectural/Engineering Services (COFPAES). COFPAES represents six architectural, engineering and surveying (A/E) professional societies:

American Congress on Surveying and Mapping
American Consulting Engineers Council
American Institute of Architects
American Society of Civil Engineers
ARTBA Planning and Design Division
National Society of Professional Engineers

The vast majority of America's practicing architects, engineers and surveyors belong to these societies. The purpose of our Committee is to promote sound Federal procurement practices for A/E services. As you may know, the Federal government is the major client of the A/E professions. We appreciate this opportunity to present our views on small business procurement issues of concern to the design professions.

When the Federal government requires A/E services it utilizes a procedure whereby: the opportunity is publically announced so that all firms have an opportunity to compete; interested firms submit their qualifications to the agency;

thereafter, the most qualified firm is selected subject to the negotiation of a fee that is fair and reasonable to the government. This process is embodied in the so-called Brooks Act, P.L. 92-582. The law has worked well and is supported by the A/E professions and the Federal construction agencies. Indeed, Congress underscored the viability of the Brooks procedure by recognizing the process as fully competitive within the parameters of the recently enacted Competition in Contracting Act (P.L. 98-369).

The A/E professions have encountered some problems in the procurement area, particularly in the designation of size standards whereby A/E firms are classified as small business and in the application of the so-called Rule of Two.

On the size standard issue, it is important to observe that the architectural, engineering and surveying professions have been struggling with SBA for years to promulgate size standards that are reflective of competitive conditions within the design professions. SBA's recent action to lower the A/E size standard from \$7.5 million and \$3.5 million to a combined A/E standard of \$2.5 million in average annual receipts is a step in the right direction. However, even under this greatly reduced size standard 97% of America's practicing architects, 95% of engineers

and 99% of surveyors are considered small business. Thus, the size standard definition is not very helpful in assisting truly small and minority A/E firms in obtaining a fair share of government business.

A basic purpose of the Small Business Act is to provide opportunity for market entry for small firms. Because practically all A/E firms are defined as small business, the smaller firms are in direct competition with larger firms. Thus, in the A/E procurement field there really is no preference opportunity for the small A/E firm because virtually all firms are defined as "small." This adverse situation for the truly small A/E firm is further compounded by the Rule of Two.

While the Rule of Two may be appropriate for many industry groups its application to the A/E professions has caused hardship, particularly to small A/E firms. Fortunately, Congress with considerable leadership from this Committee has been quite receptive to both the size standard and Rule of Two issues as they impact the A/E professions.

Last year the Congress enacted a provision (Section 921, Title IX of the Defense Acquisition Improvement Act of 1986, P.L. 99-661) that would change existing law, which permits a virtual

total set aside of all contracts in a particular industry category, to a process whereby every industry category would be entitled to receive a fair share of Federal contracts. Under this new provision, 30 percent of the value of contracts would be earmarked for small business A/Es. However, all firms - large and small - would be entitled to compete for the remaining 70 percent of Federal A/E contracts. We think this is in the spirit of various laws designed to assist small business.

Congress also directed (through Section 921 cited above) a review of size standards applicable to architectural, engineering, surveying and mapping services. The SBA would be directed to reduce the size standard for the A/E professions if over the past three years more than 30 percent of the dollar amount of Federal A/E contract awards were awarded under a set aside. We favor this review and welcome the Congressional attention that is being devoted toward small business issues.

We urge this Committee to continue to support Section 921 as it pertains to A/E contracts. We recognize, Mr. Chairman, the difficult situation this Committee confronted last year with regard to the Conference on the Defense Authorization bill that included Section 921. Nevertheless, we believe that law contains

improvements to the Small Business Act that have great merit. We hope these provisions will be fully implemented.

It might be helpful if the Committee requested of the civilian construction agencies the same A/E contracting data that the military construction agencies currently provide to the Armed Services Committees. This would give you and the A/E professions an accurate "fix" on how the various small business procurement provisions affect the A/E community.

In conclusion, we would like to bring to your attention a problem that has recently arisen. Several Federal agencies are disallowing the cost of professional liability insurance as an item of overhead. The rationale for this, according to the Defense Contract Audit Agency(DCAA), is that since the government does not sue A/Es for negligent performance there is no reason to accept the cost of insurance as an overhead item. We have pointed out to the DCAA that the Federal government is expected to and does pursue A/Es when performance is below par and that it is in both the professional's interest and the government's to have liability insurance. So far, we have been unsuccessful in persuading the DCAA that the cost of liability insurance should be an allowable overhead item. When Federal agencies do not recognize legitimate overhead items, such as professional

liability insurance, this poses particular hardship for small firms. We would welcome support from this Committee in having Federal agencies recognize the cost of liability insurance as an allowable overhead expense.

We thank you for your interest in matters affecting the design professions and appreciate your consideration of our views.

STATEMENT
OF
MARY DEL BRADY
NATIONAL ASSOCIATION OF WOMEN BUSINESS OWNERS
before the
Committee on Small Business
United States Senate
February 25, 1987

My name is Mary Del Brady. I am a small business owner in Pittsburgh, Pennsylvania. I am the President of the National Association of Women Business Owners, a trade association representing more than 2700 women-owned businesses around the country, with active chapters in 40 cities. NAWBO is affiliated with the Small Business Legislative Council, the Federation of Organizations for Professional Women, and with an international group of women business owners, Les Femmes Chefs d'Entreprises Mondiales.

The National Association of Women Business Owners was a major participant in the White House Conference on Small Business. Our chapters around the country worked hard to elect delegates to the Conference. Our leadership, our delegates, and our members worked hard also to produce an agenda of issues for that Conference to position small business owners, women and men, to do business effectively in an economy increasingly competitive, increasingly oriented toward services, information and high technology, increasingly dependent on skilled

employees, and increasingly international. We called our blueprint "Framework for the Future." I have attached a copy of it and would like to ask that it be included in the record.

I am pleased to report that more than 85% of our recommendations were among the top 25 conference recommendations. Since that time, like most small business organizations, NAWBO has identified a priority list of issues which we commend to you. Our Board of Directors adopted the following issues as our priorities:

1. Establishment of a Commission on the services, information and high technology sectors of the economy, including wholesale revision of such economic measures as SIC codes;
2. Limitation of federally mandated parental leave benefits to six week unpaid leave for birth, adoption, or sick children and enactment of incentives for broader private sector family-oriented fringe benefits;
3. Reform of the federal laws regulating the insurance industry, including better insurance industry disclosure and repeal of McCarran-Ferguson;
4. Passage of legislation to insure equal access to commercial credit;
5. Improved access to procurement for small business;
6. Improved procurement of professional and technical services, with emphasis on quality rather than lowest cost;

7. Create a small business exporting incentive program similar to the Small Business Innovation Research program (SBIR); and

8. Enlargement of the Fulbright program to include international business exchanges.

We have additional information on each of these issues and request that the record be held open to permit us to do so. We look forward to working with you on these issues and on the others which make up NAWBO's Framework for the Future.

**STATEMENT
OF
NATIONAL ASSOCIATION OF WOMEN BUSINESS OWNERS
before the**

**Subcommittee on Children, Family, Drugs
and Alcoholism**

**Committee on Labor and Human Resources
United States Senate**

February 19, 1987

My name is Mary Del Brady. I am a small business owner in Pittsburgh, Pennsylvania. I am the President of the National Association of Women Business Owners, a trade association representing thousands of women-owned businesses around the country, with active chapters in 40 cities. NAWBO is affiliated with the Small Business Legislative Council, the Federation of Organizations for Professional Women, and with an international group of women business owners, Les Femmes Chefs d'Entreprises Mondiales.

We appreciate the opportunity to testify on S. 249. NAWBO, as an organization of women business owners, has a unique perspective which should be heard in this debate. As women, many of us have had children and sought to work at the same time. Some of us have faced discrimination because we were of

child-bearing age. As employers, we have reached out to create humane environments for our employees and tend to employ larger percentages of women than businesses as a whole. As business owners, we understand the issues involved in trying to build strong businesses. It has been a painful process for our leaders and members to search for a position on legislation in this area which offers an economically viable way of meeting our employees' needs. We believe we have done so.

Before tracing the history of NAWBO's involvement and thinking on this issue, I would like to identify the key elements of our position

- o NAWBO believes that every parent should be able to take time off work to have or adopt children or care for seriously sick children without the fear of losing his or her job and without facing discrimination against women of child-bearing age;
- o Any government requirements in this area should be limited to very basic benefits, such as a six week unpaid leave for the above events with the right to return to the job;
- o Such basic benefits could even be extended to businesses with fewer than 15 employees;
- o Congress and the states should identify mechanisms to spread the cost and effective incentives which encourage private industry to expand the benefits they offer beyond the very basic ones mandated by law and which do not disproportionately impact small business; and
- o Congress should not exempt itself from requirements it imposes on private employers.

The businesses represented by NAWBO are, by and large, small businesses. As small businesses headed by women, we are sensitive to the needs of our employees who have obligations to their families. At the same time we face the everyday reality of running businesses in an increasingly competitive

environment -- nationally and internationally. We have struggled to identify a balance which is true to the values of our members and makes sense in economic terms.

One side of the balance arises from the changing nature of family and work in the United States. For generations, the public policy of the United States and the employment practices of the nation's businesses, large and small, have presumed a worker with a spouse at home to raise and care for children. However, America is not the land of the traditional family -- the married male breadwinner with a wife at home. Fewer than 10 percent of American households fit the traditional mold. Women with children have moved into the work force in enormous numbers and the number of single or divorced parents -- both male and female -- has increased dramatically. More than half of the 45.6 million children in two-parent families have both parents in the work force. Single-parent households have increased to the point where over half of the Nation's children will spend some of their lives as members of a single-parent household. At the same time, the role of men is changing, as more men choose to be more involved in their children's upbringing. The majority of American parents work and raise children. Despite these changes, maternity leave with a guaranteed right to return to the job is not universally available, in either the public or private sectors.

Small business is the major employer of these women. Almost 60 percent of employed women work for firms of 500 or less; approximately 40 percent of employed women work in firms of 100 employees or less. Small business provides most of the first employment opportunities for the nation's workers. Small firms generated most of the net new jobs in the economy from 1979 to 1983. As a major employer of women and creator of jobs, small business is a central part of the solution to the conflicts faced by employees trying to fulfill their responsibilities at work and at home.

At the same time, the economic realities of small business are far different from large business. According to three recent studies commissioned by the Small Business Association, small business wages and fringe benefits are lower than big business. Further, training costs for new employees are significant expenditures for small businesses, both in terms of on-the-job training time required of each new employee before he or she is fully productive and the time lost by supervisory and other employees in training new employees. Lastly, much of the benefit of the training is actually enjoyed by the larger businesses, since employees tend to move relatively quickly to large businesses at higher salaries, reflecting in part the training received in the small business. The State of Small Business: A Report of the President at 226-227 (1986). It cannot be assumed that what is feasible in large businesses can simply be required of small businesses as well.

As a participant in the White House Conference on Small Business, NAWBO entered the controversy over proposed federal legislation to require all employers of more than 15 employees to provide up to 18 weeks of unpaid parental leave with a guaranteed comparable job on return.

Throughout the 50 state conferences which preceded the August 1986 White House Conference, small business opposition to mandated parental leave emerged as a key issue. Nowhere was there any statement that business had a responsibility to its employees and to society to participate in the effort to find ways for employees to be productive and promotable and still fulfill their family responsibilities.

As an organization of women business owners, NAWBO believed it had a unique opportunity to encourage the business community to make it clear that opposition to federal mandated benefits did not equal opposition to participation in the effort to find better ways for employees to balance their work and family responsibilities. NAWBO therefore successfully urged the

delegates to amend a recommendation which simply opposed mandated benefits to include as well a small business call for "creative approaches in the private sector to identify new and voluntary approaches to enable working parents to fulfill their job and family responsibilities." This two-pronged resolution was the Conference's number two priority, coming in behind only a call for broad reforms in the area of liability insurance.

Following the White House Conference, NAWBO established a task force to identify creative new approaches to help small business employers accommodate the needs of employees with family responsibilities in ways which do not jeopardize the productivity and survival of the small business sector of our economy. The goal of the NAWBO task force will be to help small business find the creative approaches called for by the White House Conference resolution, bring those options to the business community, and encourage their widespread adoption. We will look at the companies who are solving the problem successfully and seek to extend their models throughout the country.

Over the months, we have struggled to find the proper balance between public and private sector involvement and to determine exactly what parts of the proposed legislation cause the most concern among our members. Among some, there is a sense that the government should not be in the business of mandating benefits at all. There is a sense that business should take on these responsibilities but without government involvement. However, concern about mandating benefits is outweighed by the very strong conviction that people in companies of all sizes should be able to have children and care for very sick children without having to face loss of their jobs. As business owners, we are concerned about the human and social issues, value our employees, and want to do what we can to attract and keep them. We also believe that working with employees to ease the conflicts between work and home will make them more, not less, productive.

At the same time, our members are concerned about the impact of the current proposed legislation on the day-to-day operation of their businesses. There are real training costs and productivity losses which extended leaves impose. In a small business, loss of supervisors, the difficulty of attracting high quality people for temporary jobs, the disruption caused by having to stretch other supervisors to cover their work, the inability to replace them cost-effectively for temporary periods, the training costs for replacing employees at all levels, the overall productivity losses arising from having to substitute temporary workers for trained ones, and the squeeze which such mandates put on the company's ability to provide other fringe benefits sought by other employees and still remain competitive -- these are all very real to women operating small labor-intensive businesses. In the last analysis, the real concern is not giving leave, but the length of the leaves proposed.

For these reasons, NAWBO believes that any legislation in this area (1) should provide a floor of six weeks mandated leave for birth or adoption and six weeks over at two year period for the care of the sick children, (2) could be extended to businesses employing fewer than 15 employees to make a basic benefit more widely available, and (3) beyond these minimums should contain Congressionally-favored incentives to encourage employers to experiment with and provide more extensive benefit packages for employed parents.

NAWBO believes the overall answer lies in a widely available minimum guaranteed leave and a voluntary flexible system which gives employers and employees more and varied minimum guaranteed leave applicable to as many employees as possible and voluntary options from which to choose -- options which will take into account the different sizes of businesses, their varying dependency on employees, their mix of supervisory and nonsupervisory employees, the varying needs of employees at different stages of their careers or in

different kinds of jobs, and the needs of those with family responsibilities which shift over time.

We believe that Congress must shift some of its focus from simple mandates to a tough look at who should bear the costs and how to encourage employers to provide broader family-oriented benefits. We urge you to look closely at existing legal barriers to family-oriented benefits and at ways to encourage such approaches as flex-time and part-time work, flexible benefit plans which allow employees to "bank" benefits in exchange for others, the use of temporary disability insurance to fund paternity leave, the utilization of other insurance to fund leave economically, and improved child care options for both healthy and sick children. We urge you to examine, for example, federal unemployment tax or other credits, the feasibility of spreading the benefit costs between employers and employees, and the removal of existing barriers to effective use of cafeteria plans and dependent care credits and assistance programs. We do not have all the answers, but would very much like to work with you and your staffs to find them.

In conclusion, we urge you to measure the legislation you pursue against these standards. Does it fulfill the needs of the employee who wants to be both productive and promotable at work and to nurture and rear children successfully? Does it fulfill society's interest in our children, the future citizens and employees on which our nation's future depends? And does it further the interest of our society in strong businesses able to create jobs and to compete successfully in an increasingly competitive business climate?

Framework for the Future:

A Priority Agenda for the White House Conference on Small Business

August 17-21, 1986



NATIONAL ASSOCIATION OF WOMEN BUSINESS OWNERS

FRAMEWORK FOR THE FUTURE: A PRIORITY AGENDA FOR THE WHITE HOUSE CONFERENCE ON SMALL BUSINESS

"If you don't know where you're going, you might end up somewhere else."

Casey Stengel, Baseball Legend

National Association of Women Business Owners

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TABLE OF CONTENTS

INTRODUCTION	5
1. THE DYNAMICS OF THE ECONOMY	7
o Services Commission/New SIC Classification System	
o Deficit Reduction	
o Unfair Competition from Government and Non-Profits	
o Deregulation of Home-Based Business	
2. INNOVATION	11
o Policy Impact on Innovation/SBIR Program	
o Government Procurement Policy	
o Acquisition of Professional and Technical Services	
o Protection of Intellectual Property Laws	
3. THE INTERNATIONALIZATION OF THE ECONOMY	15
o Cabinet Agency on International Trade, Incorporating GATT	
o Private Sector Trade Information Center	
o Export SBIR	
o Fulbright Program Expanded to Include Businesspersons	
o International Summit Small Business Conference	
4. HUMAN RESOURCES	19
o Entrepreneurial Education and International Competitiveness	
o Fulbright Program (cross-referenced)	
o Employer Retraining and Retention Accounts	
o Innovative National Policies on Families and Work	
o Social Security Taxes	
o Private Retirement Plans	
5. CAPITAL RESOURCES	23
o New Tax Incentives for Investment in Small Business	
o Three-Tiered Capital Gains Tax	
o Investment Tax Credit	
o Equal Access to Credit	
o Capital Formation/Uniformity in Securities Laws	
6. THE CLIMATE FOR SMALL BUSINESS	26
o Independent SBA	
o Small Business Involvement in Policymaking, Including Regular Conferences on Small Business	
o Liability Insurance Reform	
IMPLEMENTATION	29

INTRODUCTION

"My interest is in the future, because I'm going to spend the rest of my life there."

Charles Kettering, American Inventor

We live in an era of dramatic transformations. We incorporate innovations and new technologies into our lives and our work at a dizzying pace. Ours has become a "real-time" world, a world of change, of challenge, of complex interdependencies.

In the midst of transformation, small business and the entrepreneurial sector have become central actors on the stage of American society. We play many roles, each one contributing to the continuing health and development of the nation. Two of these functions are critical for both the present and future of our communities and our country:

- o Small business is the working laboratory of innovative new ideas, the place where new products, services and processes develop and are tested; the breeding ground for entrepreneurial, fast growth organizations that become our Inc. 100s, American Business Conference 100s, our Fortune 500s.
- o Small business is also the key to economic diversity, providing goods and services needed to support and sustain the community; creating 80 percent of the new jobs in our country; serving as the training ground for much of our work force.

Meeting the Challenge of Change

Change marks every aspect of the world in which we operate our businesses. The years since the end of World War II have seen the emergence of the world as a "global village," the internationalization of the economy, and the impact of automation in the workplace. These changes have brought profound structural shifts in specific industries and dislocations across entire sectors of the economy -- as well as the emergence of new skills, new jobs, new industries. The post-World War II era has also seen sweeping demographic changes in the work force, and more recently, the "graying of the work force" as our population ages and our birthrate dwindles.

Smaller enterprises, because of their greater flexibility, often are able to respond to change more quickly and effectively than giant firms. But regardless of size, it is imperative that firms continually innovate and renew themselves if they are to keep pace with international competition and the accelerating rate of change. Otherwise they will be replaced by newer, more vibrant enterprises that can compete -- and increasingly these will be foreign enterprises.

Staking Out a Dynamic Growth Agenda

At the 1986 White House Conference, we need to do more than draw up another laundry list. We need to think strategically about the future and its opportunities, and to formulate an agenda that can fuel this country's economy for the rest of this century and into the next. Establishing a consensus on overarching strategic objectives -- and developing both an annual and a longer-range plan to achieve them -- would give the entrepreneurial sector a strong and coherent voice in national tax, trade and economic policymaking. This is a degree of influence we have never had before, because, divided and cacophonous, we have effectively canceled out each other's lobbying efforts.

To formulate a framework for the future, we need to ask ourselves: Does this proposal encourage economic growth, job creation, innovation, productivity, competition, international trade, and enhanced industrial competitiveness? Does it rely on incentives rather than regulations, carrots rather than sticks? Does it mean more federal spending? If so, is there a substantial return on that investment? Proposals that encourage smallness for its own sake, that discourage growth or emphasize regulations, that reward inefficiency and dependency, or that are too costly would be thrown out. Those that pass muster would become our national agenda for entrepreneurship and economic growth.

Recommendations that Will Create a Framework for the Future

The National Association of Women Business Owners has identified a set of core recommendations that will help propel us toward the year 2000. Many have grown out of the work of state delegations in which NAWBO members played a leadership role in the last year. Still other recommendations are innovative new proposals to be approved by petition.

We have grouped our framework recommendations into six major areas:

1. THE DYNAMICS OF THE ECONOMY
2. INNOVATION
3. THE INTERNATIONALIZATION OF THE ECONOMY
4. HUMAN RESOURCES
5. CAPITAL RESOURCES
6. THE CLIMATE FOR SMALL BUSINESS

Linkages Across Issue Areas

These areas of concern and the issues linked to them cannot be isolated from one another. For example, keeping America competitive is addressed under both INTERNATIONALIZATION OF THE ECONOMY and HUMAN RESOURCES. It is vital that we see the linkages among issues, and reflect that understanding in voting for recommendations that will help us address the challenges facing small and growing businesses as we approach the 21st century.

Issues Cross-keyed to the Recommendation Agenda

The issues presented here form a set of core recommendations keyed to the sessions in which they will be considered. Issues arising out of a national or state recommendation include the assigned Recommendation Agenda number. In some cases, we have proposed an amendment to an existing state recommendation, or a clarification of the original language.

We believe these issues offer a framework for the future for small business, and establish an agenda for a systematic effort to assure their implementation. In our final section, we propose a mechanism for doing this.

1. THE DYNAMICS OF THE ECONOMY

"In another fifteen years, industry will offer jobs to only 8 percent of America's work force. That is one-third of the present figure. And by 2015, that 8 percent figure will be cut in half, to almost the same level as today's agricultural jobs. Just thirty years hence, there won't be many more people in factories, proportionately, than there now are on farms. Until this nation's leaders in government and business come to grips with the unsettling changes gnawing away relentlessly at America's infrastructure, the old industrial centers will go on wallowing in a past that never will return...If you spend too much time looking back, you can't spot the opportunities ahead."

Marvin Cetron, Futurist

Since the end of the Second World War, our economy has undergone major transformations, from being primarily a manufacturing economy to a services and information economy. This transformation has resulted from interactions among technological developments, systemic shifts in the structures of industries and jobs, and changes in the population. These rapid changes require effective management, but it is impossible to manage anything effectively if we do not understand its dimensions. While the federal government produces bales of statistics, comparatively little useful information is available on economic growth, innovation and emerging sectors of the economy.

Understanding the New American Economy

Lack of sound data is a practical barrier to understanding the nature, dimensions, and character of the new American economy and its dynamic entrepreneurial sector. There is particular need for an examination of such emerging areas as the services, information and high technology sectors.

As Peter Drucker noted, "The aggregates on which all statistics are built are now 50 years old. And so the great national economic aggregates have been reliable plus or minus 40 percent...If you get that much slippage and still base policy on it, your chances of doing the wrong thing are simply too great."

To help us better understand the new American economy, we urge the creation of a commission to review legislative and regulatory policies affecting the newer services, information and high technology sectors of the economy. In addition, we urge a wholesale overhaul of the anachronistic Standard Industrial Classification (SIC) codes, which provide a rearview mirror impression of the American economy.

Appropriate Roles for Government, Business and Non-Profits

Several fundamental economic issues have emerged since the last White House Conference which need to be aggressively addressed. They have to do with federal deficits, and with the appropriate roles of government, of business, and of not-for-profits in the new American economy.

One of the central roles of government concerns the level of government spending. With interest payments snowballing on the growing federal deficits, we must send a

clear message to the White House and Capitol Hill: Control deficits so as not to wreck the economy!

A key contribution of the Reagan Administration -- perhaps its lasting contribution, when historians of the third millenium AD look back on the late 20th century -- will be their raising of the challenging question, What is the proper role of government?

New Federalism initiatives led to rethinking of the appropriate relationships between federal, state and local governments. Public-private partnerships and privatization initiatives caused a reassessment of the relationships between business and government that had evolved since the New Deal. And recent changes in tax and procurement policies have profoundly altered the role of the not-for-profit sector, which has aggressively surged into commercial activities to make up for revenue losses that have occurred in the wake of changed policies.

Several key questions in this policy area still need to be adequately considered. They concern government competition with the private sector, and unfair competition from non-profits. The nature, structure and appropriate activities for each of these economic sectors need to be addressed, and appropriate policies developed.

From the Garage to Fortune 500 in Five Years

Because we live in a services and information economy, knowledge-based businesses can be located anywhere. Technology, transportation and social concerns make home-based businesses that telecommunicate a practical option for some entrepreneurs, yet federal, state and local policies lag in dealing with this issue. Changes are needed in the government's approach to home-based businesses if we are to have a climate supportive of the innovative contributions smaller enterprises can make to job creation, and to building a strong economic base for America's future. Lest we forget, Apple Computer began in a garage in 1977, and made the Fortune 500 list five years later.

Our core recommendations in this area include:

- o a commission on services, information and high technology, including a call for a new SIC code classification system;
- o deficit reduction;
- o an initiative dealing with competition from the government and non-profits; and
- o deregulation of home-based business.

RECOMMENDATIONS:

SERVICES COMMISSION/NEW SIC CLASSIFICATION SYSTEM

BE IT RESOLVED THAT a commission be established to study the impact of services, information and high technology sectors of the American economy and make recommendations with regard to appropriate federal legislation and regulation which will promote growth in this area. We also recommend expansion of the Standard Industrial Classification (SIC) Codes to more adequately reflect the services, information and high technology sectors.

PROPOSED AMENDMENT

(Add to ARIZONA -RA 262) Because government at all levels has failed to protect the private sector from damaging levels of unfair competition, BE IT RESOLVED THAT federal, state and local laws, regulations and policies should: (1) Prohibit unfair competition in which not-for-profit organizations use their tax-exempt status and other advantages in selling products and services also offered by the private sector (for example, federally funded research and development centers, which receive \$5 billion in sole source contracts per year); and (2) Prohibit direct, government-created competition in which government activities perform commercial services which deny businesses the opportunity to perform activities under government contract. (NOTE: Details of implementation are included in a thoughtful recommendation sponsored by the Business Coalition for Fair Competition.)

BE IT FURTHER RESOLVED THAT there be established a **Federal Private Enterprise Review**, with members named by the President and confirmed by the Senate, which shall be made up of private citizens committed to small business, serving as a permanent advisory group to the Chief Counsel for Advocacy of the Small Business Administration and the Director of the Office of Management and Budget.

DEREGULATION OF HOME-BASED BUSINESSES

BE IT RESOLVED THAT the governmental disincentives directed against home-based business owners be eliminated.

(NEW JERSEY - RA 311 - REGULATION AND PAPERWORK)

2. INNOVATION

"Change is...essential...to economic growth...In this speeding world of ours, if we do not anticipate innovation, it may be too late to react. Innovation, if we keep abreast of it, will indeed be the factor in winning the race with change."

Jim Pickard, Secretary of Commerce, Commonwealth of Pennsylvania

Innovation, the basic tool of the entrepreneur, is the purposeful and organized search for changes in both processes and products, the systematic analysis of the opportunities such changes might offer for economic, social and technical development, and the actual development and application of such changes. The wisdom to recognize the time for innovation and the shape it should take is the hallmark of the successful growth enterprise, whether it is a hardware store, restaurant, or professional services corporation, manufacturing firm or high technology enterprise. It should also be the hallmark of governmental and non-profit organizations.

Innovation is a concern of all small and growing businesses, not just firms whose work requires research and development activities. Management consultant Peter Drucker aptly describes innovation as "the systematic sloughing off of yesterday."

Innovation Is Broader than SBIR

Because the Small Business Innovation Research (SBIR) Program -- perhaps the flagship small business program -- was up for reauthorization, the state and regional White House Conferences focused almost exclusively on its reauthorization and expansion.

But innovation requires a broader approach than SBIR.

The promotion of innovation must become an urgent national priority if U.S. businesses are to become more competitive in the international economy. The executive and legislative branches at all levels of government must take responsibility for promoting innovation. Innovation needs to become a paramount consideration in the application of all basic functions of government: taxation, regulation, education, promotion of R&D, procurement, international relations, and policy development.

The role of government in promoting innovation must be flexible, changing according to both the size of the business it affects, as well as the point in the continuum of the innovation process at which it is applied. Smaller firms, for example, have a greater need for governmental assistance, and experience greater proportionate impacts from regulatory burdens than their larger counterparts. In addition, the proper role of government changes as businesses move through the innovation continuum -- from invention, basic research, feasibility and application studies, prototype development, initial production and commercialization, right on through to marketing and mature production.

Government and universities, large firms and smaller firms, all must promote innovation in partnership. Each must promote the progress of ideas from the invention stage through to commercialization, in a smooth, rapid and unobstructed manner. Government should serve as a catalyst and information clearinghouse in this process, not as an impediment to innovation.

Catalyzing Innovation through Procurement

One of the most direct ways in which government can catalyze innovation is through the almost \$200 billion in goods and services it purchases each year.

Acquisitions by NASA and the Defense Advanced Research Projects Agency (DARPA), for example, have helped catalyze extraordinary growth in post-World War II industries such as semiconductors, computers and sophisticated new services which operate in a synergistic relationship with new technologies. Steps must be taken to streamline and simplify procurement, while at the same time opening up access to smaller businesses, including those owned by women and minorities. We further recommend that prime contractors receive incentives for increasing their use of small businesses, as well as for providing management and technical assistance that will help these smaller businesses grow.

Federal procurement policies, which were designed primarily to procure widgets at the lowest possible cost, must be overhauled so that contracting officers can effectively acquire sophisticated new professional and technical services in cases where quality should be a more important consideration than the lowest cost. To improve acquisition of sophisticated services, procurement personnel will require additional technical training.

Protecting Intellectual Property

Finally, we urge that the U.S. government take steps to protect intellectual property.

Our core recommendations in this area include:

- o impact analysis of federal policy on innovation/reauthorization and expansion of SBIR;
- o procurement improvement and simplification;
- o a new method for acquiring professional and technical services; and
- o expansion of intellectual property laws.

RECOMMENDATIONS:

ANALYSIS OF LEGISLATIVE AND REGULATORY IMPACT ON INNOVATION/SBIR PROGRAM

BE IT RESOLVED THAT Congress and the executive agencies should recognize the importance of systematic innovation to all small business enterprises--including innovations in processes of organization, management, and the delivery of goods and services. Accordingly, they should develop specific mechanisms for encouraging and supporting a climate of innovation and individual activities leading to innovation, including:

- a. Systematic assessments of the impact of new and existing legislation on product and process innovation;

- b. Development of a variety of government programs supporting innovation, including but not limited to the permanent reauthorization and expansion of the SBIR; and
- c. Active support through specific programs in federal agencies of small business R&D consortia, including models of small business/small business collaboration, small business/large business, small business/university, and small business/university/large business partnerships.

(DISTRICT OF COLUMBIA - RA 136 - INNOVATION)

GOVERNMENT PROCUREMENT POLICY

BE IT RESOLVED THAT the federal government should increase its awards to start-up and small businesses to bring the percentage in line with small business' contribution to the gross national product by:

- a. Creating a blue ribbon commission to review and recommend changes in public policy, incentives and regulations to reshape procurement practices to achieve full participation by start-up and small businesses to be tested on a limited basis by the Office of Federal Procurement Policy;
- b. Requiring each agency to publish a biennial contract plan that ensures that set-asides are spread evenly across all procurement areas and specify which procurement will be set-aside;
- c. Simplifying and expediting the procurement process;
- d. Providing incentives for government procurement officials and prime contractors to increase their use of small businesses; and
- e. Set-asides should be spread evenly across all procurement areas for small businesses with special attention to minorities and women.

(MARYLAND - RA 282 - PROCUREMENT)

(NOTE: NAWBO anticipates supporting an amendment to Maryland's RA 282 that would ease "graduation shock" for companies transitioning out of their small business size standards.)

ACQUISITION OF PROFESSIONAL AND TECHNICAL SERVICES

BE IT RESOLVED THAT the GAO should conduct a study of professional and technical services. GAO should examine agency conduct with respect to cost and quality tradeoffs in professional and technical services contracts, and frequency of prohibited practices such as technical leveling and cost auctioning. GAO should report the results to Congress and the Office of Federal Procurement Policy (OFPP).

OFPP should develop and implement on a demonstration basis a simplified alternative acquisition process adapted to the procurement of professional and technical services, which would ensure to the government the benefits of competitively procured professional and technical services.

Congress and OFPP should require technical training for federal program and contracting personnel concerning the acquisition of professional and technical services, to assure that high quality services are obtained in cases where quality is more important than cost.

(DISTRICT OF COLUMBIA - RA 269 - PROCUREMENT)

EXPANSION OF PROTECTION OF INTELLECTUAL PROPERTY LAWS IN INTERNATIONAL MARKETS AND TO COVER NEW TECHNOLOGIES

BE IT RESOLVED THAT the federal government take action to strengthen the protection of United States intellectual property rights in international markets.

BE IT FURTHER RESOLVED THAT Congress give careful consideration to the recently released Report of the Congressional Office of Technology Assessment which concludes that current federal intellectual property laws may no longer be able to adequately serve desired economic, political and social goals in an age of electronics and information; and that Congress act now to establish an agency for the collection of data and further analysis of the new technologies being developed, to assist Congress in enacting appropriate legislation for the expansion of the intellectual property law system to adequately cover these new technologies.

(NAWBO PETITION - INNOVATION)

3. THE INTERNATIONALIZATION OF THE ECONOMY

"We are moving toward a world system composed of units densely interrelated like the neurons in a brain."

Alvin Toffler, Author

The internationalization of the economy is a phenomenon which affects small business as well as larger firms. Technological and economic changes, as well as advances in transportation and communications, have created a world where men's shoes may begin life as cattle in the Midwest, but the hides are tanned in Brazil, worked into uppers and soles in the British Virgin Islands and Haiti, and assembled into shoes in Puerto Rico (Made in the USA), or Barbados and Jamaica for shipping to Europe. Many larger firms are now more transnational than national in their scope.

The internationalization of the economy has generated production sharing, joint ventures and growing attention to international trade among firms of all sizes -- among services firms as well as goods-producing industries. Job dislocations, deficits in the balance of payments, and trade wars underscore the need for serious initiatives in trade policy.

The Need for Serious Trade Initiatives

A coherent and integrated approach to trade policy through creation of a cabinet-level agency on international trade would be a quantum-leap improvement over our current crazy-quilt assortment of trade-oriented departments and agencies. And adding agriculture, services and intellectual property to sectors included under the General Agreement on Tariffs and Trade (GATT) would be another leap forward. In addition, we support the creation of a Trade Information Center.

To encourage smaller firms to move into international trade, we urge that incentives be developed which will encourage them to participate in exporting, through the adoption of an exporting policy mechanism similar to the catalytic Small Business Innovation Research (SBIR) vehicle passed at the 1980 White House Conference -- demonstrably one of the most innovative and successful pieces of federal legislation in recent decades.

Innovative Educational Initiatives Imperative

Because international factors play such a substantial role in determining the health of the economy through trade, foreign investment and the shifting of markets, these issues have critical implications for education. Educational issues include the international and multicultural dimensions of our curricula at the elementary, secondary and college levels, as well as the continuing education initiatives which are mandatory if American business is to remain competitive. We need global dimensions in all education, and more opportunities for those involved in both smaller and larger enterprises to better understand other nations, their languages, and the way they do business (See Trade Agency recommendation in this section, as well as HUMAN RESOURCES).

For forty years the Fulbright Program has supported the exchange of American students and academic scholars with students and scholars from other nations. The benefits in international understanding from that program have been incalculable. The time has

come to expand the Fulbright exchanges to include individuals in business and industry. We must expand opportunities for Americans in business to learn about other cultures and how we may work with them more effectively, and give businesspersons in other nations an opportunity to better understand the United States, its people and business practices.

Summit Small Business Conference Called For

Finally, to catalyze international small business involvement with policy formulation and international trade, we support a Summit Small Business Conference in 1990, to do on an international level what the White House Conference on Small Business accomplished in 1980, and hopefully will accomplish in 1986.

Our core recommendations for this critical area include calling for increased emphasis on the international dimensions of the economy through:

- o an integrated cabinet-level agency on international trade, incorporating the strengthening of GATT to include agriculture, services and intellectual property;
- o establishment of a Private Sector Trade Information Center;
- o creation of an "Export SBIR" mechanism;
- o expansion of the Fulbright program to include international business exchanges; and
- o a Summit Small Business Conference in 1990.

RECOMMENDATIONS:

CABINET AGENCY ON INTERNATIONAL TRADE

BE IT RESOLVED THAT in order to deliver more streamlined and cost-effective government services to small business, a cabinet-level Department of International Trade be established in order to:

- a. Coordinate dissemination of information regarding education and training, licensing, trade missions, Foreign Sales Corporations (FSCs), market-driven data bases, SIC code updates and other functions.
- b. Represent small manufacturing, agricultural, services, and other businesses, as well as large businesses, in national and international discussions and negotiations on issues such as: General Agreement on Tariffs and Trade (GATT); aggressive and swift reciprocal trade policies, including elimination of the Foreign Corrupt Practices Act; foreign currency exchange matters; and a long-term national policy regarding international trade.
- c. Provide an educational forum to assist in the development of a curriculum on geography, foreign languages and intercultural practices at all levels of the public educational system.

(ILLINOIS - RA 140 - INTERNATIONAL TRADE)

(See also WISCONSIN - RA 141 which is virtually identical and could be consolidated with the Illinois Recommendation)

PROPOSED AMENDMENT

Add to ILLINOIS - RA 140: "d. Establish a clearinghouse on export and import information; and which would place particular emphasis on (1) recognizing, promoting and advertising of service industry exporters; (2) expanding and making more flexible requirements for small business participation in EX-IM bank loan programs; and (3) simplifying export licensing procedures."

(Amendment based on MASSACHUSETTS - RA 158 -
INTERNATIONAL TRADE)

PRIVATE SECTOR TRADE INFORMATION CENTER

BE IT RESOLVED THAT there should be recognition, promotion and advertising of service industry exporters through the establishment of a Trade Information Center.

(MARYLAND - RA 157 - INTERNATIONAL TRADE)

PROPOSED AMENDMENT

NAWBO supports the following amending language to MARYLAND - RA 157 recently proposed by the Maryland delegation in lieu of the above recommendation:

In order to educate America's business owners about doing business outside the domestic market place, and to develop a major focus on small business participation in international trade, we recommend that a private sector Trade Information Center be established and that government make available all information at its disposal to help implement the Center's objectives. The Center will establish a computerized information network throughout federal, state, and local government, assist business owners in joint ventures, develop trade missions, provide background information to businesses, identify grants, funding, or tax incentives available for a particular industry or country, develop cultural and language education programs for our schools, provide one-on-one counseling to help new businesses enter international trade, and facilitate the entry of female and minority trade participation on trade councils and trade missions.

EXPORT "SBIR"

BE IT RESOLVED THAT there be created incentives for small business to increase exports through (a) creation of an annual export incentive awards program similar to SBIR and (b) retention and improvement of the Small Foreign Sales Corporation.

(VIRGINIA - RA 156 - INTERNATIONAL TRADE)

FULBRIGHT PROGRAM

BE IT RESOLVED THAT the Fulbright program be enlarged to include a component for international business exchanges, open to men and women from firms of all sizes and types, with options that offer:

- o Short-term exchanges of three to six months, with intensive language and cultural training programs to precede these exchanges; and
- o Full-year exchanges along the line of the traditional Fulbrights, again preceded by an intensive language and cultural training program.

These exchanges should not be limited to the countries of Western Europe but should include Latin America, the Pacific Rim and the Far East, Africa and the Middle East.

(NAWBO PETITION - INTERNATIONAL TRADE)

SUMMIT SMALL BUSINESS CONFERENCE

BE IT RESOLVED THAT the President, and if necessary and desirable, the Congress, should urge the leaders of the industrially advanced nations who attend the Summit conference in Italy in 1987 to sponsor a "Summit Small Business Conference" to be held in 1990. The conference should be titled "Expansion of the Small Business Share of World Trade." Its goal should be to develop specific agreement among Summit nation small business people as to how best to achieve such an expansion.

Planning and management of the Conference should be in the hands of a representative group of small business people named by the participating nations. Conference attendees should be elected and appointed in a manner parallel to that followed in the United States White House Conference on Small Business. Each participating nation should provide its delegation with research and information support during the three preparatory and planning years. The Conference should be free to consider and recommend changes in national and international laws, regulations, policies and institutions which will expand small business' share of world trade.

(ARIZONA - RA 169 - INTERNATIONAL TRADE)

4. HUMAN RESOURCES

"Lifelong reskilling of the work force will now become a critical problem because any set of skills may be obsolete in 5 to 10 years. The great frontier of American education is now going to start at 22, after we get out of school, and continue all our lives."

D. Bruce Merrifield, Assistant Secretary for Productivity, Technology and Innovation, U.S. Department of Commerce

As Paul Strassman has noted in his recent book, *INFORMATION PAYOFF*, "Enhancing human capital is essential for future economic growth." This is particularly true for America, with its sophisticated services and information economy. Strassman estimates that about 63 percent of all working days in the United States are devoted to information work, and as much as a quarter of the time of all non-information workers is spent in information work.

Shifts in our economy are leading to rapid changes in job content and structure -- creating an ever-changing demand for varying skill mixes in workers. Rapidly developing technologies are further reshaping our work patterns, information needs and the locations where we work. At the same time, demographics of the work force in the United States are undergoing a dramatic transformation. Women are continuing to move in overwhelming numbers into the work force, and more and more children are finding both their parents in the full-time work force. As our birthrate dwindles and our population ages, the "squaring of the demographic pyramid" is giving us an older work force, with many younger, entry-level workers not educationally or technically equipped for the changing world of work.

Training and Constant Retraining Called For

Changes in the composition, skill levels, needs and demographics of the work force make it imperative for the business community to become an active participant in the training and constant retraining of their work force. Indeed, investment in human capital must become one of America's two or three top national priorities if we are to meet the challenges of change and international competition.

In addition to training and retraining, enlightened human resources policies require attention to our employees' conflicts between work and family. Payroll and unemployment taxes, and pension and retirement policies, also require thought. As the post-World War II "baby boomers" continue to age, older workers will have a profound impact on retirement policy and on society generally.

Human resources recommendations designed to lead us into the 21st century and beyond include:

- o entrepreneurial education and international competitiveness training;
- o expansion of the Fulbright Program to include businesspersons;
- o employer retraining and retention accounts;
- o innovative national policies on family and work;
- o Social Security taxes; and
- o private retirement plans.

RECOMMENDATIONS:

ENTREPRENEURIAL EDUCATION/INTERNATIONAL COMPETITIVENESS

BE IT RESOLVED THAT the federal government should encourage the advancement of entrepreneurial education in the existing school system and support the development of continuing entrepreneurial education through workshop environments by instructors with hands-on experience.

(TEXAS - RA 45 - EDUCATION AND TRAINING)

PROPOSED AMENDMENT

(To include INTERNATIONAL COMPETITIVENESS feature)

We recommend that the Texas Recommendation be amended to read as follows:

BE IT RESOLVED that the federal government should encourage the advancement of entrepreneurial education in the existing primary and secondary school and university systems, including the teaching of foreign languages and intercultural practices, to increase our national awareness of global economies and their interaction, and to encourage greater competitiveness by small business in international markets. The federal government should further support the development of continuing entrepreneurial education through workshop environments by instructors with hands-on experience.

(Amendment based on CONNECTICUT - RA 46 - EDUCATION AND TRAINING)

FULBRIGHT PROGRAM

See description under "The Internationalization of the Economy."

EMPLOYER RETRAINING AND RETENTION ACCOUNTS

BE IT RESOLVED THAT small businesses be allowed to establish a reserve account in a trust from pre-tax income to help extend the employment, training or retraining of employees during periods of economic recession or other financial crises.

(COLORADO - PETITION - EDUCATION AND TRAINING)

INNOVATIVE NATIONAL POLICIES ON FAMILIES AND WORK

BE IT RESOLVED THAT the Conference opposes federal legislation to mandate parental leave benefits because of its extraordinary financial impact on small businesses, but strongly supports creative efforts in the private sector to identify new approaches which enable working parents to fulfill their job responsibilities and at the same time devote adequate time and attention to their children. Society's overwhelming interest in the children and families of our nation's future demands no less. We urge consideration of such approaches as use of insurance to fund leave, flex-time and part-time work, flexible benefit plans which allow employees to "bank" benefits in exchange for others, and improved day care options.

(The above serves as an amendment to North Dakota's RA 209 and Tennessee's RA 210, rejecting parental leave - PAYROLL COSTS)

SOCIAL SECURITY TAXES

BE IT RESOLVED THAT Social Security taxes be reduced for both the employer and the employee when alternate retirement programs such as 401(k) and IRA are utilized.

(KANSAS - RA 213 - PAYROLL COSTS)

PROPOSED AMENDMENT

We recommend that KANSAS - RA 213 be amended to read as follows:

BE IT RESOLVED THAT in order to work toward solvency of the Social Security system without further increasing the tax burden for employers or employees, Social Security taxes should be reduced for the employer and the employee when alternate qualified pension plans and retirement programs such as 401(k) and IRA are utilized.

BE IT FURTHER RESOLVED THAT contributions made to IRAs, 401(k) plans and other qualified pension plans shall continue to be tax deductible at their current levels.

PRIVATE RETIREMENT PLANS

BE IT RESOLVED THAT the private pension and fringe benefit system sponsored by small business should be promoted by a simplification of filing requirements and by giving parity to small business plans with large plans. The "hassle" provisions recently enacted by Congress in this area should be repealed. Attempts to legislate mandated benefits should be rejected.

(MARYLAND - RA 239 - PAYROLL COSTS)

PROPOSED AMENDMENT

NAWBO supports the following amending language to MARYLAND - RA - 239 which has recently been proposed by the Maryland delegation in lieu of the above recommendation:

BE IT RESOLVED THAT for the retirement security of our nation's employees and the continued viability of the private pension system, Congress must support and promote the private pension system sponsored by small business. Congress must sponsor only changes to the private pension system which allow employers to increase benefits or contributions which repeal discriminatory laws against small plans and which simplify filing requirements and paperwork. Section (401) (k) plans and IRAs should be maintained at present levels (rather than the cutback envisioned by the Tax Reform Act of 1986) to promote individual savings for retirement for all taxpayers.

5. CAPITAL RESOURCES

"Money is the seed of money, and the first guinea is sometimes more difficult to acquire than the second million."

Jean Jacques Rousseau, French Philosopher

To maintain growth and dynamism, small businesses need available and accessible capital resources. When smaller firms seek outside financing, either in the form of debt or equity, they can quickly become entangled in an intricate web of interdependent factors that affect the flow of capital in an internationalized economy.

A variety of external financing options are available to small businesses, including:

- o traditional bank loans, sometimes including equity participation agreements;
- o venture capital financing through stock purchases or use of limited partnerships;
- o industrial development bonds;
- o financings involving business development credit corporations;
- o credit card financing; and
- o government assisted financing programs, such as loans guaranteed by the Small Business Administration or other federal agencies, research and development assistance, and a host of other federal-agency-backed alternatives.

Availability and Accessibility Are Twin Concerns

The cost and availability of capital in each of these options is determined by a complex interplay of public and private market forces. Tax policies, federal spending policies and programs, the federal budget deficit, international and domestic monetary policies and trade policies, the trade deficit and trade imbalances, federal, state and local lending laws and practices, discount rates, and international banking laws all interact with each other, but also exert a collective impact on each financing alternative. The small firm that looks outside of its own retained earnings for financing enters a complex world filled with harsh realities and factors over which it has little control.

In addition, many smaller firms find access to capital limited because the banking community does not understand the needs of small businesses--particularly those in services, or "soft-asset, knowledge-based" businesses, as Susan Winer noted in *Inc.* magazine; "the banks still have not learned to lend against brains." Minority and women-owned businesses suffer further from attitudes regarding women and minorities that sometimes work against their obtaining credit.

Even businesses which attempt to capitalize from internally generated resources find that the "silent partner" of taxes can dramatically affect the ability to retain capital.

The core recommendations on capital resources address the problems of availability and accessibility of capital resources for changing and growing small firms by focusing on both the larger and the individualistic forces that shape the flow of capital:

- o tax incentives for capital formation and small business investment;
- o three-tiered capital gains tax;
- o investment tax credit;

- o equal access to commercial credit; and
- o streamlining the securities laws.

RECOMMENDATIONS:

NEW TAX INCENTIVES FOR INVESTMENT IN SMALL BUSINESS

BE IT RESOLVED THAT the Congress and Administration, in cooperation with private enterprise, should develop new capital formation vehicles, and adopt tax incentives that deal specifically with investment in small business.

(PENNSYLVANIA - RA 57 - FINANCE)

PROPOSED CLARIFYING LANGUAGE

BE IT RESOLVED THAT the Congress and Administration, in cooperation with private enterprise, should develop new capital formation vehicles and adopt tax incentives which encourage investment in small business and which are strictly related to small business.

THREE-TIERED CAPITAL GAINS TAX

BE IT RESOLVED THAT a Federal capital gains tax be enacted which will provide savers and investors with a three-level risk-reward incentive.

(a) A normal Federal capital gains tax rate 10 percent below the maximum rate for individuals as an incentive to the formation of capital, provided that it shall apply only to gains from investments in operating businesses (regardless of size) which provide employment, whether to family members or others with a holding period of 24 months;

(b) a small business capital gains rate at 50 percent of the normal capital gains rate, limited to gains made from investments in employing operating businesses, and kept in those businesses for at least five years; and

(c) an entrepreneurial capital gains rate, available to a taxpayer only once in his or her life for a gain made from the sale of an interest in a business which was small or a full-time manager-owner for at least fifteen years; the tax rate on such gains to be zero for the first (\$500,000) - (\$1,000,000) of gain, and 40 percent of the normal capital gains rate for gains in excess of that amount... (This form of capital gains tax would not be available to corporations, partnerships, trusts or other business entities as such; except for venture capital companies, Federally licensed SBIC's etc. It would be otherwise available only to individuals.)

(PETITION RE: THREE-TIERED CAPITAL GAINS - TAXATION)

INVESTMENT TAX CREDIT

BE IT RESOLVED THAT the Investment Tax Credit (ITC) be retained, but limited to the first \$500,000 of qualified properties purchased per annum.

(MICHIGAN - RA 323 - TAXATION)

EQUAL ACCESS TO CREDIT

BE IT RESOLVED THAT Congress enact legislation to ensure equal access to credit for all small businesses and to ensure that women and minorities are not discriminated against in the granting of commercial credit.

(ARIZONA - RA 74; COLORADO - RA 75 - FINANCE)

CAPITAL FORMATION/UNIFORMITY IN SECURITIES LAWS

BE IT RESOLVED THAT Small Business Participating Debentures (SBPD) should be adopted and enacted into law; and that the federal government adopt standards and regulations preempting all state laws so that small business can meet Regulation D at the federal level. That the SEC and the respective states aid small businesses by increasing the dollar amount that can be raised by reliance upon the exemption provided by Rule 504 and other appropriate rules that aid the financing of small businesses.

(IOWA - RA 63 - FINANCE)

PROPOSED AMENDMENT

We would amend the first sentence of Iowa's Recommendation to read as follows:

"Capital formation vehicles which would encourage investment in small business, such as the Small Business Participating Debenture, should be adopted and enacted into law; and that the federal government adopt legislation preempting all state laws with respect to small offerings specifically relating to investments in small business in order to achieve uniformity between state requirements and regulation D on the federal level, and therefore necessitate compliance by small business with only one regulation."

6. THE CLIMATE FOR SMALL BUSINESS

"Federal policy must create a climate that supports entrepreneurship, rather than impedes it. Too often it appears to be the other way around."

Mary Del Brady, President, the National Association of Women Business Owners

There are some issues of vital concern to small business in the United States that do not fit neatly into any of the five categories already presented. They are, however, transforming the environment within which small business functions in this country, and belong in any core group of recommendations setting the agenda for the future of small business.

These include the future of an agency for small business, small business representation in federal policymaking, the need for regular national conferences dealing with small business policy, and liability insurance reform. The first three get to the heart of federal government's understanding of the role and needs of small business, and will provide a permanent framework for small business participation in the policy-shaping process. The fourth, the insurance crisis, affects the very existence of firms, from manufacturing companies to day care centers and professional services enterprises. All four will help to improve the regulatory environment for small business.

Increased Representation Is Imperative

The structure and role of a federal agency concerned with small business is a true proxy of the nation's understanding of the contributions of the small business and entrepreneurial sectors to the economy. The diversity and mixture of this sector work against full understanding by both the general public and by governmental agencies. Without a strong, visible and high-level presence in the nation's capital--via an independent agency, ongoing representation on policy-making councils, and via future White House Conferences--the contributions of small and growing businesses will be underestimated, the economy will lag, and international competitiveness will elude us.

Liability Concerns

The problems small businesses have with liability insurance are dramatic examples of the lack of understanding and concern for the functions of smaller enterprises in the economy. Some of the potentially fastest growing new service areas such as child care, along with traditional manufacturing enterprises, are threatened by the liability insurance crisis.

Our core recommendations for creating a better climate for innovative, entrepreneurial firms include:

- o continuation of an independent agency for small business;
- o greater small business involvement in national policymaking, including future national conferences on small business; and
- o reform in liability insurance.

RECOMMENDATIONS:

INDEPENDENT SBA

BE IT RESOLVED THAT the SBA should be retained as an independent agency and elevated to a cabinet level position to assist the small business community, with the private sector having a stronger partnership role.

To ensure that SBA's mission remains focused on areas of greatest need:

- a. The independent role of the Office of Advocacy must be maintained and strengthened.
- b. The Congress should mandate a comprehensive review of all SBA programs to assess their efficiency and their appropriateness to the broad needs of the small business community. That review should be conducted with substantial input from the private sector with the leadership of the small business constituency.
- c. In the delivery of lending and management assistance services, SBA should be directed to increase its reliance on the local resources in the private business sector which have expertise in its program areas.

(MISSOURI - RA 106 - FUTURE OF AN AGENCY FOR SMALL BUSINESS)

(NOTE: NAWBO supports the MISSOURI - RA 106 in the proposed amended version as indicated above. The bold portions above emphasizes that the SBA should be an independent agency and in part b. replace the words "under the direction of " with suggested new language)

SMALL BUSINESS INVOLVEMENT IN POLICYMAKING

BE IT RESOLVED THAT all federal boards and commissions dealing with the issues relating to small business should have fair representation from the small business community. This process could be monitored through local, state and federal business groups and organizations.

(MICHIGAN - RA 29 - ECONOMIC POLICY)

PROPOSED AMENDMENT

We would recommend amending MICHIGAN - RA 29 to read as follows:

BE IT RESOLVED THAT all federal boards and commissions dealing with the issues relating to small business should have fair representation from the small business community and that all federal agencies shall create a senior executive

position, reporting directly to the head of the agency, which shall serve as a representative of small business in all policymaking by that agency.

BE IT FURTHER RESOLVED THAT a White House Conference on Small Business should be scheduled for 1990 while Congress is in session, with subsequent conferences every four years.

(Amendment based on WASHINGTON - RA 35 - ECONOMIC POLICY)

LIABILITY INSURANCE REFORM

Because the liability insurance crisis in the United States has not only become a life and death sentence to many small businesses, but also is changing adversely our way of life, BE IT RESOLVED THAT we obtain relief by pursuing a four-pronged effort at reform: tort reform; federal standards for product, professional and commercial liability; regulation of the insurance and re-insurance industries; and viable, affordable alternatives to liability coverage through casualty insurance companies.

(MARYLAND - RA 180 - LIABILITY INSURANCE)

NOTE: Very similar to Pennsylvania's RA 172.

IMPLEMENTATION

"Our challenge is to educate policymakers to the fact that risk, entrepreneurship, innovation, and growth are not liberal or conservative issues; rather, they represent an urgent national priority that Congress must address if we are to maintain our industrial competitiveness, create jobs..., expand economic opportunity...and...propel the American economy into the twenty-first century."

Virginia Littlejohn, Inc. magazine

Over the last year, small business leaders across the nation have invested time, money and other resources in preparing for the White House Conference on Small Business. The work of the Conference truly begins, however, when these days in Washington are over and we have shaped an agenda for action. If the investments we have made are to pay off, we must continue to be involved in the implementation of the agenda we have set.

Creation of the Committee for Small Business 2000

We propose the formation of the Committee for Small Business 2000, composed of an executive committee of 12, and two representatives from the delegation of each state, the District of Columbia, and Puerto Rico. The functions of the Committee for Small Business 2000 will be to:

- o Launch the implementation of the agenda set by the White House Conference on Small Business, and alert the delegates to federal proposals supporting or working against the agenda;
- o Coordinate strategy for implementation of the agenda with the various groups representing small business in Washington, while remaining independent of any individual organization; and
- o Serve as an informal "think-tank" on long-term issues affecting small and growing businesses.

The work of the Committee for Small Business 2000 will be brought to the attention of the small business and entrepreneurial community, Congress and the executive agencies through a newsletter, special alert bulletins, and occasional papers on key issues.

The Committee will be organized as a not-for-profit group, and be funded through an initial assessment of participating state delegations, with other funds coming from foundations.

Important Players in the Main Event

As Jay Finegan pointed out in his insightful August 1986 Inc. magazine article about the White House Conference, "Real power and influence is better gained by climbing out of the special-interest rut and acting and thinking like important players in the main event. When it comes to the new American economy, small business is very much the main event. It generates 80% of the nation's new jobs, and accounts for nearly half of the nation's output of private goods and services. It is at the cutting edge of technological change... Rather than worrying about special tax breaks and set-asides," he continues, "why should small business not move toward playing the dominant role in setting the government's overall economic agenda, from interest rates and money supply to trade policy and the dollar?"

That is the task before us as we move toward the year 2000.

STATEMENT
OF
HOPE EASTMAN
NATIONAL SMALL BUSINESS UNITED
before the
Committee on Small Business
United States Senate
February 25, 1987

My name is Hope Eastman. I am a partner in the law firm of Paley, Rothman & Cooper and am the volunteer Chair of the Legislative Committee of National Small Business United.

NSBU is a new national trade association formed from the recent merger of the National Small Business Association, a multi-industry trade association founded in 1937, with Small Business United, a coalition of regional, state and metropolitan small business associations organized in 1981. NSBU represents 50,000 small businesses nationwide.

We appreciate the opportunity to share our members' views and concerns with you. We are looking forward to working with you on initiatives to improve the business climate for small business in our economy.

NSBU ISSUES PROCESS

Member development of issue priorities is key to the nature of our organization. Once a year, NSBU holds what can best be described as our own White House Conference on Small Business. There are some differences. Instead of being held every four

years, our conference is held every year. Instead of being held in Washington, D.C., we select a location outside of Washington in a different location each year. This year's conference -- known as the Annual Leadership and Issues Retreat -- was held in San Diego, California in January. Next year's retreat will be in Miami, Florida.

The NSBU issues agenda is developed, written, debated, and voted upon by the members -- small business owners from across the country. All members are entitled to participate in the decision-making process. The retreat is organized and run by members who volunteer their time to do so.

This year, we began with the issues adopted at the White House Conference on Small Business and developed our own priorities among those issues. We will follow our legislative retreat with our Washington Presentation, scheduled for May 19-20. Members are encouraged to come to Washington to participate in this event. The purpose of the Presentation is for our members to bring our issues and concerns directly to the attention of the Senators and Representatives from their home districts. Of course, NSBU does not wait until May to begin its work on the issue priorities. Today is part of the process.

NSBU LEGISLATIVE PRIORITIES

I would like to identify the top 15 priority issue areas and respond to any questions you may have.

1. Business leadership in Voluntary Employee Benefits; Opposition to Mandated Benefits.

2. Capital Gains Tax to Encourage Small Business Investment.

3. Civil Justice Reform.

4. Preservation of the SBA as an Independent Agency.

5. Federal Uniform Product Liability Legislation.

6. Deficit Reduction.

7. Unfair Competition from Tax-Exempts and Government.

8. Commission to Study Services, Information and Emerging Technology Sectors of Economy and Revitalization of SIC Codes.

9. Direct Investment Write-Off.

10. Line-Item Veto

11. Minimum Wage.

12. Privatization.

13. Increase Small Business Participation in Procurement.

14. Direct Expensing to Increase Capital Retention.

15. Insurance Industry Regulation and Reform.

We thank you for your time and would be happy to respond to your questions. We would also appreciate the record being kept open so that we may supply you with more detailed information on each issue as soon as it is available.

Statement of
The Associated General Contractors of America
Presented to the
Committee on Small Business
United States Senate
on the Subject of
Small Business Issues
February 25, 1987



AGC is:

- o More than 32,500 firms including 8,400 of America's leading general contracting firms responsible for the employment of 4,000,000-plus employees;
- o 106 chapters nationwide;
- o More than 80% of America's contract construction of commercial buildings, highways, industrial and municipal-utilities facilities

The Associated General Contractors of America represents more than 32,500 firms, including 8,400 of America's leading general contracting companies which are responsible for the employment of more than 4,000,000 individuals. These member contractors perform more than 80 percent of America's contract construction of commercial buildings, highways, industrial and municipal-utilities facilities.

This statement of the Associated General Contractors of America:

- o Voices AGC's support for the amendments to the Small Business Act passed by the 99th Congress in Public Law 99-661;
- o Expresses AGC's concern over one section of a bill that has been introduced in this Congress, S. 328, which if enacted, will allow the federal government, for the first time, to force itself into the private contractual relationship between a general construction contractor and its subcontractor, and to dictate the payment terms of that private contractual relationship; and
- o Voices AGC's support for restoration of the differential treatment of long-term capital gains.

AGC Support for Changes to SBA's Set-Aside Programs

AGC supports the changes to the SBA's set-aside programs made by the Congress in P.L. 99-661, especially those changes which:

- 1) would require agencies to ensure that a fair proportion of contracts be awarded to small businesses in each industry category, rather than overall contracts; and
- 2) would require SBA, after October 1, 1987, to adjust the size standards for specified industries to levels at which no more than 30 percent of the contracting opportunities in those industries would be set aside for exclusive competition among small businesses.

Construction is one of the industries in which agencies have set aside a disproportionate number of contracts for exclusive participation by firms labelled by the SBA as small businesses -- despite the industry's often-stated belief that set-aside programs are not needed in construction. Breaking down the Small Business Act's "fair proportion" requirement by industry category should result in the agencies freeing up a greater number of federal construction procurements to the open competitive marketplace, thereby maximizing competition and assuring the taxpaying public that the government's needed facilities are being procured in the most efficient and economical manner possible.

AGC also supports the provision contained in P.L. 99-661 which would direct SBA to reduce the size standard in certain specified industries -- among them, construction, -- to levels at which no more than 30 percent of the government's contracting opportunities in those industries would be set aside for exclusive small business participation. Stated differently, at least 70 percent of the construction contract dollars awarded by federal agencies would be awarded under circumstances in which all businesses -- large, medium and small -- would be allowed to compete.

While AGC continues to believe that set-aside programs are simply not needed in construction, AGC respectfully suggests that Congress allow these changes to the SBA's set-aside programs to take effect, at least as they pertain to the construction industry. AGC is convinced that the result will be a healthier, more competitive federal construction marketplace, to the benefit of the entire construction industry and the government alike.

AGC's belief that set-aside programs are not needed in construction stems from the basic fact that the construction industry is truly one of the last bastions of the free enterprise system, and as such, is a national haven for small businesses. This industry is typified by family-owned businesses which jealously guard their integrity and reputation in the community, in an extremely competitive and open industry. Construction is not dominated by a few firms, rather it is dominated by the open competitive bid system. That is, competition in terms of price and ability to complete the task determines which companies win contracts. Depending on the nature of the construction project, the general contractor may complete the work with his own forces, or may subcontract the specialty work as may be necessary to complete the job.

The industry is also one of but a few that permit an individual -- any individual -- to make a start with little or no capital. An emerging construction firm generally uses credit to buy materials and arranges for short term loans to pay for equipment rental and labor costs. This ease of entry into the industry helps to safeguard and assure competition in the industry.

In 1963 the Administrator of the Small Business Administration directed that a study be instituted to look at the construction industry to detail its characteristics. The study looked at the economic factors that influence the industry to determine if the then-emerging SBA programs were applicable to construction. The findings of that study are as follows, and are as valid today as they were in 1963:

- o "There can be no question but that the application of any measures of competitiveness to the building and construction industry would result in the conclusion that it should be ranked among the least concentrated or more competitive. It is not dominated by a few large firms.
- o The industry is comprised of a very large number of enterprises.
- o The industry is comprised of small enterprises by conventional standards.
- o There is a very high rate of business births in construction. None of the major industry categories had an entrance rate as high as construction.
- o The financial costs of entry to the industry are relatively low in many branches. Equipment may be rented. Workmen typically furnish their own tools. In many cases owners and clients may advance part of the capital.
- o The scale of operations in the construction industry reaches efficient levels at a relatively small size. The technology of the industry does not require large scale operations and large capital costs, compared to industry generally, in order to achieve efficient operations.
- o Construction enterprises have few fixed costs and move readily from locality to locality and even region to region, increasing materially the degree of competition in a single locality. Work opportunities attract bidders from far and wide.
- o The bidding takes place on a specifically defined project. All bidders are furnished the same specifications and plans, and in the typical case, the competitors are bidding on a precisely defined and identical product.

- o The subcontracting system, characteristic of construction projects, enhances the competitive nature of the industry. Each successful bidder may consider whether to perform the work or subcontract a portion of it in turn.
- o Contractors face keen competition from prospective clients who prefer to perform work themselves. Industrial enterprises, householders, and local, state and federal government agencies affect competitive conditions in construction by performing an appreciable amount of construction work themselves.
- o The above features of the construction industry suggest that the construction industry is already relatively highly competitive among sectors, and that the need for using the influence of federal contracts to increase competitiveness deserves a low priority in construction. The use of set-asides in construction needs to be placed in this perspective."

AGC believes these facts lead inescapably to the conclusion that the characteristics of the construction industry assure ample opportunity for qualified contracting firms of all sizes to obtain a share of federal construction outlays.

In the construction industry small businesses are extremely competitive. They are quite capable of competing head to head with firms that do not qualify as small according to SBA's ever-changing definitions. In the private sector there is no such thing as a set-aside program. Here the open, unrestricted competitive bid system determines which firm will be awarded the contract. In the private sector smaller construction firms thrive and are able to obtain a fair proportion of the available market.

Open competition is what the construction industry is all about. Open competition is what the government should be seeking to assure the highest quality product at the lowest possible price. With the use of set-aside programs, competition is restricted and this is detrimental to all parties involved.

In the past, AGC has urged a moratorium on the use of the small business set-aside program and the 8(a) program in construction to confirm its contention that these programs are unneeded. This suggestion has of course not been implemented. It is AGC's contention that a moratorium will result in little change in the number of contract actions that are awarded to small businesses by federal agencies. AGC views a moratorium as a true test to see if a government program which has been in effect for over 30 years is still necessary.

AGC believes that the best interest of the taxpaying public and the construction industry would be served by total elimination of all special preference programs from the construction procurement system. Permit the free market in construction to work -- and it will work in the public sector as it demonstrably works in the private sector.

AGC Opposition to Section 7 of S. 328

In 1982 Congress passed the Prompt Payment Act to ensure that the government would make timely payments to its contractors. The Act imposed time limits for the making of payments, and imposed late payment interest penalties on the government for its failure to make timely payments. The Act, however, had some loopholes. One of those loopholes involves the question of whether construction contracting is covered by the Prompt Payment Act.

In the last Congress AGC strongly supported amendments to the Prompt Payment Act of 1982 to clarify that progress payments on federal construction contracts are specifically covered by the law, and that the Government must pay interest to its construction contractors, many of whom are small businesses, when it is late in making payments.

AGC considered these amendments to be equitable and overdue. They would have been of direct benefit to subcontractors as well, since the faster government agencies pay general contractors, the faster their subcontractors will be paid.

Passage of these needed amendments was burdened, however, by the inclusion of provisions mandating payment procedures on subcontracts. In this new Congress, AGC is once again supporting needed amendments to the Prompt Payment Act, contained in the Prompt Payment Act Amendments of 1987, S. 328.

Attempts are being made once again, however, to unnecessarily mandate the intrusion of the federal Government into the private contractual relationship between the general contractor and its subcontractors through the inclusion in S. 328 of a provision (Section 7) which would require general contractors performing federal construction work to include so called "prompt payment" clauses in their subcontracts. Section 7 of the Prompt Payment Act Amendments of 1987 is entitled, "Payment Clause for Subcontracts Under Construction Contracts."

AGC emphasizes that prompt payment to subcontractors is not at issue. Prompt payment procedures are, in fact, already in use in the document which legally and appropriately defines the obligations and responsibilities of the parties to a subcontract -- the private contractual agreement which exists between the general contractor and its subcontractor.

All private subcontracts have provisions detailing payment procedures. These are negotiated between the general contractor and the subcontractor. All these private subcontracts also provide for remedies in the event payment to subcontractors is not made in accordance with the terms of the subcontract. AGC's standard subcontract and all other industry model subcontracts already provide for prompt payment as well as for remedies in the event payment is in dispute.

Prompt payment to subcontractors is also not a problem on government construction contracts. If it were, the federal construction contracting agencies would be aware of such problems, and yet, the record is devoid of such information from government construction contracting agencies. AGC believes that government agencies are not receiving complaints of slow pay from general contractors to subcontractors which are not linked to slow pay from the government owner to the general contractor.

What is at issue is allowing the federal government to intrude into a private contractual relationship and dictate the terms in that private contractual relationship. Section 7 of S. 328 is precedent setting. The federal government has never before injected itself directly into the business terms of subcontract agreements. The only area in which the federal government has injected itself involving subcontract matters involves National interest socio-economic programs.

AGC must question whether the federal government is willing to take on the increased responsibility and liability which will be the result of allowing Section 7 to intrude into private contractual relationships between the subcontractor and the general contractor.

Some of these areas of increased responsibility and liability include:

- o To enforce Section 7, government contracting officers will be required to not only enforce its payment provisions, but also its retention provisions. The government will necessarily become embroiled in payment disputes and adequacy of performance disputes between general contractors and subcontractors.
- o The general contractor provides the government agency with performance and payment bonds. A performance bond assures the government that the general contractor will complete its work. A payment bond assures the government that the general contractor pays its subcontractors and material suppliers. With these bonding assurances, backed by reputable surety firms, the government agency can safely make full and rapid payment to the general contractor.

Subcontractors do not provide these same bonding protections to the general contractor. Consequently the general contractor must use one of the few tools available to it to assure adequate and on-time performance by a subcontractor, and to assure that subcontractors pay their sub-subcontractors and suppliers. That tool is payment to the subcontractor. If the government, through implementation of Section 7, eliminates that "tool", is the government ready to accept the responsibility and liability of lack of performance on the part of the subcontractor or lack of payment by the subcontractor to its sub-subcontractors?

-10-

- o Under Section 7 a general contractor, under a two-year construction contract with the government, would be required to pay its subcontractor in full upon completion of the subcontractor portion of the work, which may occur six months after the start of the contract. If, however, at the completion of the entire two-year construction project, a defect is found in the work that the subcontractor completed and was fully paid for 18 months ago, is the government ready and willing to assume total liability for the necessary corrections in that work since the government required the general contractor to pay that subcontractor upon completion of his portion of the work?

The government, through the years, has properly avoided these types of responsibilities and liabilities by contracting with one party and one party only through a single contract with the general contractor. Consequently, these responsibilities and liabilities have rested where they properly belong -- with the general contractor in administering his subcontracts. Section 7 would negate that and thrust these liabilities on the government.

As an attachment to this statement, AGC offers for the Committee's information and review, an analysis of the impacts that Section 7 of S. 328 will have on government construction contracting, prepared by the Washington, D.C. law firm of King & King. AGC believes that the analysis will reinforce the association's position that Section 7 of S. 328 is totally unnecessary and wholly unwarranted.

AGC seeks the support of the Committee on Small Business for removing Section 7, the subcontract payment provisions, from S. 328.

AGC Support for Differential Treatment of Long-Term Capital Gains

The Tax Reform Act of 1986 included two provisions, which when taken together, will have a far-reaching impact on closely held businesses, including those in construction. These provisions are:

- o Repeal of a fifty-year old Supreme Court decision commonly known as the General Utilities doctrine; and
- o Repeal of the preferential tax treatment of long-term capital gains.

Repeal of the General Utilities Doctrine

In one of the most far-reaching changes in the Tax Reform Act of 1986, the Act repealed the Supreme Court's General Utilities doctrine after over fifty years of use. This doctrine allowed only a single tax to be paid at the shareholder level for gains on certain liquidating sales and distributions. Under the new law, the corporation must recognize a gain or loss as if it had sold its assets to the shareholders at fair market value. Therefore, the corporation will have to pay a corporate level tax on the full amount of appreciation in the business, and the shareholders, or owners, of the firm will then have to pay a tax on the distribution that is made to them.

The new law does provide a special exception to the rule on corporate liquidations for small, closely held corporations valued at \$10 million or less and having more than half of the stock owned by 10 or fewer individuals for five years or longer. However, to take advantage of this exception, liquidation must occur before January 1, 1989, and the full benefits of the exception are only available to firms valued at \$5 million or less.

This exception is too narrow to be of great help to most owners of construction firms. Many small businessmen and women would like to sell their firms at some future date based on their age and retirement plans, not on a provision of tax law.

The repeal of the General Utilities doctrine materially alters the economics of buying and selling businesses. Two taxes must now be paid before the new owner of the business obtains a fair-market basis in the company.

Repeal of the Preferential Tax Treatment
of Long-Term Capital Gains

Under prior law, only 40 percent of long-term capital gains were taxed, lowering the maximum tax rate to 20 percent (50 percent top tax rate x 40 percent of gains). The Tax Reform Act repealed the deduction of 60 percent of capital gains, so all capital gains will now be taxed as ordinary income, with the top rate of 28 percent. The combination of the repeal of the General Utilities doctrine and the elimination of the differential treatment of capital gains will increase dramatically the federal tax levied on the sale or liquidation of a closely held business.

In addition, 31 of the 42 states that tax capital gains apply their tax to the gain reported on the federal return. Unless these states change their tax codes, they will automatically levy their tax on 100 percent of the taxpayer's gain.

The impact of these new provisions can be seen in the following example:

A California businessman started a construction company thirty-five years ago and it is now valued at \$10 million. He is 52, and wants to sell the company and retire in 5 years. His children do not want to take over active management of the firm, and do not have enough interest to keep the company with a professional manager. Under prior law, he could sell his company and 40 percent of the value in the company would be taxed to him as a long-term capital gain (federal and state capital gains taxes would total 20.6 percent). Under the new law, a corporate level tax is assessed when the company is sold or liquidated, then the full value of the company is taxed as a capital gain (new federal and state taxes would total 35.9 percent). He would have very little left to show after a lifetime of building his construction company.

One of the final recommendations of the 1986 White House Conference on Small Business was to recommend not only a differential treatment of long-term capital gains, but also a sliding scale with an entrepreneurial capital gains tax rate available only to a former or present founder, or full-time manager-owner who has held the investment for at least fifteen years receiving a more favorable capital gains rate.

AGC encourages the Small Business Committee to address this issue on behalf of entrepreneurs and founders of small businesses nationwide.

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HAROLD I. ROSEN

February 18, 1987

HAND DELIVERED

Mr. John W. Sroka
 Executive Director - Occupational Divisions
 Associated General Contractors of America
 1957 E Street, N.W.
 Washington, D.C. 20006

Re: Prompt Payment Act Amendments of 1987

Dear Mr. Sroka:

You have asked me to address the impact that Section 7 of the proposed Prompt Payment Act Amendments of 1987 will have on construction contracting. Section 7 contains the provisions that would require government construction contractors to include prompt payment provisions in their subcontracts and purchase orders calling for payments under subcontracts and purchase orders in accordance with prevailing industry standards and requiring the payment of late payment interest penalties. These provisions will have tremendous impact on the present procedures for payments under subcontracts and purchase orders. Moreover, these changes are totally unnecessary and wholly unwarranted. My detailed comments regarding the proposed subcontract provisions are enclosed.

I hope AGC is successful in having the subcontract payment requirement removed from the proposed Prompt Payment Act Amendments.

Very truly yours,

Harold I. Rosen
 Harold I. Rosen

HIR/jls
 Enclosure

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COMMENTS UPON SECTION 7 OF THE PROPOSED
PROMPT PAYMENT ACT AMENDMENTS OF 1987

Introduction

The Prompt Payment Act of 1982 was promulgated to ensure that the government would make timely payments to its contractors. The Act imposes time limits for the making of payments and imposes late payment interest penalties on the government for its failure to make timely payments. The Act, however, has some loopholes. The Prompt Payment Act Amendments of 1987 are intended to close those loopholes.

One of those loopholes involves the question of whether construction contracting is covered by the Prompt Payment Act. One of the purposes of the Amendments is to clarify that construction procurement is indeed subject to the terms of the Prompt Payment Act. With regard to construction contracts, the Amendments go considerably beyond that purpose.

Section 7 of the Amendments Goes Entirely
Beyond The Intent Of The Prompt Payment Act

Section 7 of the Prompt Payment Act Amendments goes considerably beyond bringing construction contracts under the terms of the Act. The Amendments would also require government construction contractors to include payment provisions in their subcontracts and

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purchase orders calling for prompt payments under the subcontracts and purchase orders. Furthermore, under the terms of section 7, those payments would have to be made in accordance with prevailing industry standards. Section 7 would go even further and prescribe a penalty or remedy for late payments to subcontractors in the form of late payment interest charges.

The Prompt Payment Act was never intended to address the payment terms between the government's contractors and its subcontractors and suppliers. Therefore, section 7 of the Prompt Payment Act Amendments goes entirely beyond the intent of the Prompt Payment Act and tremendously broadens the scope of the Act. For that reason alone, section 7 has no place in the Prompt Payment Act Amendments of 1987.

Section 7 Violates The Historic Privity
Of Contract Relationship Between
Contractors And Their Subcontractors

Payment is a material term of any contract or subcontract. For a contract to be valid, it must include the terms of payment. Subcontracts and purchase orders always include payment provisions. The terms of payment are established through negotiation by the contracting parties. It is a matter properly determined by the parties who are in privity of contract with one another.

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Privity of contract is a concept that was developed hundreds of years ago by the English common law. Privity is the connection or relationship which exists between two or more contracting parties having a derivative and mutual interest in a contract. Third parties not a party to a contract have no privity of contract. Historically, the rights and obligations of parties in privity are paramount to the rights and obligations of any third party. In fact, in only very limited circumstances can a third party gain any right in a contract between two other parties.

The privity relationship between parties is of the highest priority and should be protected by the law. The rights of those parties to determine and agree upon the terms of their contract should be left to the parties. Interference with that privity relationship, including the rights and obligations arising from the contract, should be restricted. The imposition of payment requirements by the government in subcontracts interferes with ~~that~~ privity of contract principle.

The Federal Government Has Never Before
Projected Itself Directly Into The Terms
Of Contractor-Subcontractor Agreements

Privity of contract is a paramount principle whose integrity has generally not been interfered with by the federal government. The only areas in which the federal government has injected itself

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involving subcontractor matters involves socio-economic programs of the federal government. This includes such things as minority business enterprise development and the employment of handicapped and war veterans. These programs address areas of concern to the nation as a whole and are intended to promote equality and equal opportunity. The federal government has never injected itself into business terms of subcontract agreements having no bearing on social or economic goals of the country. Section 7 is the first instance of such an intrusion by the federal government.

While section 7 is the first instance in which the federal government has ever attempted to impose material provisions into subcontract agreements, it has on occasion ventured indirectly into subcontractor matters. In those instances, it was found that the federal government's intrusions created more problems than they solved. For example, a number of years ago, the Bureau of Reclamation of the Department of the Interior and the General Services Administration decided to require prime contractors to list with their bids proposed subcontractors they intended to use on government projects. Such subcontractor listings were intended to reduce bid shopping and bid peddling and coincidentally were strongly supported by subcontractor organizations. However, the subcontractor listing requirements resulted in serious impediments to the procurement system. A multitude of bid protests and lawsuits ensued. It was impossible to effectively administer the subcontractor listing program. As a result, the subcontractor listing requirements were dropped.

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The mere listing of subcontractors created overwhelming problems. It would have to be anticipated then that the imposition of payment terms into subcontracts will generate even further administrative burdens than did the subcontractor listing requirements.

Another area in which the federal government has strongly avoided imposing itself involves the area of subcontractor claims. Subcontractor rights and remedies, including claims and claims procedures, are the subject of the terms of each subcontract and the applicable law. Claims are generally governed by the subcontract terms. Those terms are a matter of negotiation and subcontract drafting skills. Claims matters between subcontractor and prime contractor under those terms are best left to the subcontracting parties. The government has recognized this in the past.

The Commission on Government Procurement studied whether to allow subcontractors to have direct access to the administrative boards of contract appeals and to the United States Claims Court to pursue subcontractor claims for which the federal government was responsible. After extensive hearings and investigation, the Commission on Government Procurement, concluded as follows:

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On balance, we have concluded that, although some inequities presently exist with respect to the treatment of subcontractor claims, these inequities are best handled by improved subcontract administration by the prime contractor with appropriate supervision by the Government. The additional problems of contract administration and program management that would arise if subcontractors were given direct access to the Government in disputes and claims outweigh the benefit to be gained. However, Government contracting agencies must remain alert to problems associated with subcontractor claims and assure that those resulting from Government actions are decided fairly.

[Report of the Commission on Government Procurement, Vol. 4, p. 31 (1972)]

The Commission on Government Procurement therefore decided that the government should not inject itself into subcontractor claim matters. Congress reaffirmed that conclusion with the promulgation of the Contract Disputes Act of 1978 [41 USC §601 et seq]. That act does not permit subcontractors to have direct access to the administrative boards or courts. Again, Congress recognized the importance of the integrity of privity of contract between contractors and their subcontractors.

Coincidentally, subcontractor claims often involve claims for payment. It stands to follow that if the federal government should not be involved in subcontractor claims, it should not be involved in subcontractor payment matters that are often so related to claims.

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Section 7 Will Draw The Federal
Government Into The Administration
Of Subcontract Payment Matters

Section 7 will necessarily require administrative regulation and enforcement. The subcontractor payment provisions can not be self-enforcing. Section 7 will undoubtedly draw the federal government into subcontractor payment matters. There is no valid reason for the federal government to become involved in subcontractor payment administration and enforcement.

In this regard, it should be recognized that the regulation of industry has its points of diminishing returns in which the detriments outweigh the benefits of regulation. Regulation of government contracts is a subject of great concern both to the government and to its contractors. As a result of extensive over-regulation of government contracting, Congress enacted the Office of Federal Procurement Policy Act of 1974 in part to centralize and simplify government procurement regulation. One result of the Act was the promulgation of a government-wide Federal Acquisition Regulation to govern all executive agency federal procurement activities. However, in addition to the Federal Acquisition Regulation, every executive agency has also maintained its own supplement to the Federal Acquisition Regulation so that in effect government procurement activities are now regulated by one overriding set of regulations as well as a multitude of additional individual agency regulations.

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Section 7 will only provide an additional area for more regulation and administration by the Executive agencies. At the same time, there is no countervailing benefit to that additional regulation.

Section 7 Will Also Adversely Interfere With
Private Contract Rights And Procedures

Payment terms are a material element of any subcontract. Moreover, subcontracts often contain their own provisions for the resolution of disputes and for remedies. Section 7, if adopted, will only serve to erode the rights of the parties in determining the terms of their own agreements. It will negate or otherwise interfere with the private remedies for payment violations which the contractors and their subcontractors are now entitled to determine by their right to contract. Prime contractors and subcontractors must maintain that flexibility in dealing with one another. Each subcontract must be treated separately.

Different contractors prefer to administer their subcontracts in different ways. Different subcontractors have their own ways of administering their business arrangements. Payment terms are one area of those differences. The Federal government should not dictate an end to those differences. Section 7 removes some of that flexibility that the private contracting parties now maintain.

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As a related matter, subcontractors often do not furnish payment and performance bonds to their prime contractors. In those cases, payment flexibility is even more critical to prime contractors. Payment procedures and bonding requirements are both essential tools to the prime contractor in managing his subcontractors.

The Government Has The Protection Of The Miller
Act To Protect Its Payments — The Government's
Prime Contractors Do Not Have Similar Protection
For Their Payments To Subcontractors

With regard to payment bonds, the Miller Act [40 USC §270A] presently requires prime construction contractors to furnish payment and performance bonds to the government. Performance bonds assure the government that the prime contractors will complete their work. Payment bonds assure the government that prime contractors will pay their subcontractors and materialmen. These bonds are furnished by the government's prime contractors. They are not furnished by subcontractors and materialmen.

The Miller Act therefore provides protection to the government for its payments to its prime contractors. Payments can be made promptly by the government to the contractors with the assurance that there is a right of surety indemnification from the payment bond surety in the event it is later concluded that the payments were for some reason improper. The prime contractor does not have that Miller

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Act payment bond to fall back on if his payments to subcontractors are later found to have been prematurely or erroneously made. The prime contractor therefore needs added flexibility with regard to subcontractor payments.

The prime contractor's payment bond even provides an adequate and effective remedy for subcontractors and suppliers in the event of nonpayment by prime contractors. In fact, prejudgment and postjudgment interest is also available to subcontractors under the Miller Act.

With the Miller Act payment bond protection, there is no need for Congress to go further to provide additional payment assurances to subcontractors. At the same time, without subcontractor payment bonds, prime contractors must have added flexibility in dealing with their subcontractors.

There Are No Prevailing Industry Standards For
Payments Under Subcontracts And Purchase Orders

Section 7 of the proposed Prompt Payment Act Amendments will require construction contractors to pay their subcontractors and vendors in accordance with prevailing industry payment standards. However, there are no prevailing industry payment standards. The

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contract terms between the contractors and their subcontractors and suppliers determine when payments are to be made. Every contract is different.

Even standard form subcontract agreements do not provide uniformity in payment practices. For example, the Associated General Contractors' standard Subcontract For Building Construction provides that payments to subcontractors shall be made no later than seven days after receipt by the contractor of payment from the owner for that subcontractor's work provided the subcontractor has provided like security to that provided by the prime contractor to the owner. At the same time, the American Institute of Architects Standard Form of Subcontract provides that payments will be made to subcontractors within three working days of the date of receipt of payment by the prime contractor. Other standard forms contain other payment terms. The subcontract form being prepared by the Section of Public Contract Law of the American Bar Association intends to leave payment terms open to the negotiation of the parties.

Most of the larger construction companies have their own general forms for subcontracts and purchase orders. Vendors and subcontractors also have their own forms. These forms are often modified as part of the negotiation process leading to the subcontracts and purchase orders. In any event, those forms provide no uniformity of practice in the establishment of dates for payments. Each subcontract agreement stands on its own.

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Subcontract Payments Are Not
Susceptible To Standard Practices

In addition to the fact that there are no prevailing industry standards for subcontract and purchase order payments, subcontracts and purchase orders are not susceptible to the establishment of standard practices. The one unique thing about construction is that no two construction jobs are alike. Conditions from one project to the next are never the same. Subcontract conditions too are that variable.

Construction contracts normally are either lump sum or unit price in nature. Subcontract work and material purchases are normally not separately identified as separate pay items in prime construction contracts. Instead, subcontract work and material purchases are only a small part of individual prime contract prices. As a result, payments under subcontracts and purchase orders do not necessarily track with payments under prime contracts.

Normally, prime contractors are paid certain percentages of particular contract prices for work items as progress payments. The fact that, for example, 50 percent of a lump sum pipe installation work item has been completed, does not mean that the pipe supplier has completed 50 percent of his work. In fact, the supplier may have already supplied all of the pipe under his purchase order. Conversely, the pipe supplier may have provided only 25 percent of the pipe but the construction contractor has opened all of the pipe trench

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so that overall the pipe installation work is considered to be 50 percent complete. Regardless, a 50 percent payment to the prime contractor for the pipe installation work does not mean that the pipe supplier is entitled to payment of 50 percent of the purchase order price. The payment to the subcontractor is a matter to be resolved by the prime contractor and the subcontractor according to the terms of their subcontract.

Standard subcontract payment practices can not establish a subcontractor's entitlement to payment. Moreover, it would be an impossible task to attempt to develop and enforce standard practices. Congress is venturing too far with section 7 and its intent to establish and rely on industry standards for subcontractor payments.

Aside From Restricting The Private
Contract Rights Of Prime Contractors
And Subcontractors, Section 7 Will
Impose Even Added Risks To
Prime Construction Contractors

As a related matter, the subcontractor payments contemplated by section 7 could work some additional inequities upon prime contractors clearly not contemplated by Congress. Subcontract work finishes in stages. For example, a foundation excavation subcontractor may complete his work two years before a building is completed. The structural concrete subcontractor may finish the concrete skeleton of that same building a year before the building is finished. Under section 7, those subcontractors would be paid after

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the prime contractor is paid. If the excavation subcontractor's work is found to be incomplete or deficient during the course of the concrete work, that subcontractor would probably have been paid and the prime contractor would have little or no recourse against the subcontractor. On the other hand, the government would be holding the prime contractor's performance bond guaranteeing that the prime contractor (not the subcontractor) will complete or correct the foundation subcontractor's work. The same would be true for all of the work performed by subcontractors. Section 7 therefore places further risk upon the prime contractor.

Construction Subcontracts Are Even
Less Susceptible To Industry
Standards Than Supply Subcontracts

It is unusual that the Prompt Payment Act Amendments should isolate construction subcontracts for special treatment regarding subcontractor payments. Construction subcontracts are more unique than supply subcontracts and purchase orders. Construction conditions differ that much more than supply contract conditions. While there is no valid basis for the government to get involved in any subcontract payments under any government contract, there is even less reason to impose by law payment provisions in construction subcontracts and purchase orders. There is no rational basis for the distinction Congress would make between supply and construction contracts by section 7 of the Prompt Payment Act Amendments of 1987.

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Summary and Conclusion

In summary, section 7 of the Prompt Payment Act Amendments will have an adverse impact on construction contracting. It will disturb existing practices and procedures in the prime contractor and subcontractor relationships. It will restrict the rights of both prime contractors and subcontractors to negotiate their own subcontract agreements.

Section 7 represents a major interference by the federal government in private contract matters. Section 7 is an intrusion by the federal government into the contractual relationship between the government's contractors and its subcontractors and suppliers. It is a basic violation of the principle of privity of contract. At the same time, section 7 provides no countervailing benefit to the government or the economy.

The subcontract payment requirement of section 7 will also present administrative difficulties for the federal government. For this reason alone, the federal government should not place itself directly into private contract matters.

Finally, the payment of subcontractors is not an appropriate subject requiring remedial legislation. This is one area in which Congress should resist the temptation for overregulation. Section 7 of the Prompt Payment Act Amendments of 1987 should be stricken.

NATIONAL ASSOCIATION OF INVESTMENT COMPANIES

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TESTIMONY

BY

DONALD F. GREENE

LEGISLATIVE CHAIRMAN

OF THE

NATIONAL ASSOCIATION OF

INVESTMENT COMPANIES

BEFORE THE

SENATE SMALL BUSINESS COMMITTEE

FEBRUARY 25, 1987

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EMILIO L. SERRANO
Ibero American Investors Corp.
Rochester, New York

GOOD AFTERNOON. I AM DON GREENE, PRESIDENT OF MINORITY EQUITY CAPITAL COMPANY, INC. (MECCO) IN NEW YORK, AND LEGISLATIVE CHAIRMAN OF THE NATIONAL ASSOCIATION OF INVESTMENT COMPANIES (NAIC). I AM PLEASED TO HAVE THE OPPORTUNITY TO APPEAR BEFORE THE SENATE SMALL BUSINESS COMMITTEE TODAY AS YOU DEVELOP YOUR LEGISLATIVE AND OVERSIGHT AGENDA FOR THE NEXT TWO YEARS.

MY PURPOSE IS TO PRESENT SEVERAL CRITICAL PRIORITIES OF CONCERN TO NAIC MEMBERS AND THE SMALL BUSINESS COMMUNITY THAT WE SERVE. I WOULD HOPE THAT THE COMMITTEE WILL BE SENSITIVE TO OUR PRIORITIES, AND THAT THEY BE FULLY EXPLORED AND BE MADE A PART OF THE AGENDA.

THE MESBIC VENTURE CAPITAL PROGRAM PLAYS A SIGNIFICANT ROLL TO ENHANCE MINORITY ENTREPRENEURSHIP, EMPLOYMENT, AND GOVERNMENT TAX REVENUE GENERATION. LAST YEAR ALONE, OUR COMPANIES INVESTED \$145 MILLION IN 1,440 MINORITY-OWNED BUSINESSES, CREATING OR MAINTAINING AN ESTIMATED 18,720 JOBS AND GENERATING GOVERNMENT TAX REVENUES OF ALMOST \$140 MILLION. A MULTIPLIER OF AT LEAST 2 WAS TRIGGERED BY THE \$145 MILLION YIELDING \$435 MILLION IN BUSINESS FINANCING MADE AVAILABLE TO BUSINESSES OWNED BY THE SOCIALLY AND ECONOMICALLY DISADVANTAGED PERSONS. THE MESBIC PROGRAM PRODUCED ALL THESE BENEFITS ON THE RELATIVELY SMALL FEDERAL DOLLARS LEVERAGE OF \$39 MILLION LAST YEAR: \$435 MILLION ON \$39 MILLION OF LEVERAGE.

WITH THE OUTSTANDING RESULTS THE MESBIC INDUSTRY CONTINUES TO PRODUCE YEAR AFTER YEAR, WE QUITE FRANKLY ARE PUZZLED OVER WHY

THE ADMINISTRATION CONTINUES TO TRY TO ELIMINATE THE PROGRAM WITH CRIPPLING BUDGET CUTBACKS. DURING THE PAST SEVERAL YEARS, THE ADMINISTRATION WANTED TO ZERO US OUT ALONG WITH MOST OF THE REST OF THE SMALL BUSINESS ADMINISTRATION (SBA). THIS YEAR, THE ADMINISTRATION HAS INTRODUCED A PROPOSAL THEY CLAIM WILL MAKE US MORE "SELF-SUSTAINING". REGARDLESS OF HOW THE ADMINISTRATION HAS CHOSEN TO LABEL ITS PROPOSAL THIS YEAR, THE END RESULT IS STILL THE SAME - THE REDUCTION OF LEVERAGE AVAILABILITY CAN ONLY LEAD TO OUR DEMISE.

NAIC OBJECTS TO THE ADMINISTRATION'S BUDGET PROPOSAL FOR THREE PRINCIPAL REASONS; MESBICS NEED THE CONTINUED AVAILABILITY 1) OF PREFERRED STOCK LEVERAGE, 2) THE VIABILITY OF THE PROPOSED MESBIC GUARANTEE PROGRAM IS QUESTIONABLE AT BEST AND, 3) THE TOTAL FUNDING LEVEL IS INSUFFICIENT.

NAICs CHAIRMAN HERBERT P. WILKINS TESTIFIED BEFORE THIS COMMITTEE YESTERDAY DETAILING OUR CONCERNS REGARDING THE FIRST TWO POINTS. I WOULD JUST LIKE TO SUMMARIZE OUR PERSPECTIVE ON THE ISSUE OF FUNDING CUTS. THE COMBINED/DIRECT GUARANTEED FUNDING IN THE ADMINISTRATION'S PROPOSAL IS INSUFFICIENT, EVEN ASSUMING ACCESS TO THE FULL \$34 MILLION. MESBICS WERE EXPERIENCING A FUNDING SHORTAGE WHEN OUR APPROPRIATIONS WERE \$46 MILLION. WE'RE NOW EXPERIENCING LEVERAGE APPLICATION BACKLOGS OF SIX MONTHS. CUTTING OUR FUNDS FURTHER IS CERTAIN TO EXACERBATE THE PROBLEM.

- 1) VENTURE FINANCING WILL BE APPRECIABLE SLOWED
- 2) PRIVATE CAPITAL EXPANSION WILL BE HAMPERED
- 3) NEW LICENSEES CANNOT BE ATTRACTED TO THE INDUSTRY

THE MESBIC INDUSTRY IS THE ONLY INDUSTRY TOTALLY DEDICATED TO MINORITY FINANCING. DESPITE THE ADMINISTRATION'S ATTEMPTS TO ELIMINATE US, WE HAVE SURVIVED AND REMAINED AGGRESSIVE IN SEEKING OUT INCREASING NUMBERS OF MINORITY SMALL BUSINESS INVESTMENTS. BUT HOW LONG CAN WE BE EXPECTED TO CONTINUE PUTTING ALL OUR RESOURCES OUT TO SMALL BUSINESSES WHEN OUR FUTURE ACCESS TO ADDITIONAL FUNDS IS CONSTANTLY UNDER ATTACK? AN ADVERSE BUT CLEAR SIGNAL IS BEING SENT TO PRIVATE CAPITAL MARKETS.

WE URGE THE COMMITTEE TO OPPOSE THE ADMINISTRATION'S BUDGET PROPOSAL. ALTHOUGH WE AGREE WITH THE SPIRIT OF THE PROPOSAL TO MOVE MESBICS INTO A MORE SELF-SUSTAINING POSITION, THIS PLAN WOULD NOT ACHIEVE THE OBJECTIVE. THE ONLY THING THE ADMINISTRATION'S PROPOSAL WOULD ACCOMPLISH IS A REDUCTION IN OUR ACCESS TO FUNDING WITH A SHARP INCREASE IN THE COST OF THOSE SCARCE FUNDS. THE PROPOSAL EVENTUALLY WOULD FORCE MANY MESBICS OUT OF BUSINESS. AT MINIMUM, THE NAIC MEMBERSHIP MUST HAVE THE MAINTENANCE OF THE FY-87 LEVERAGE AVAILABILITY FOR FY-88 OF \$39 MILLION INCLUDING PREFERRED STOCK LEVERAGE AND SUBSIDIZED DEBENTURES. WE OPERATE IN A HIGH RISK MARKET PLACE WHERE EQUITY CAPITAL PLAYS AN UNUSUALLY IMPORTANT ROLE.

ON THE OTHER HAND, THE PROPOSAL TO CREATE THE CORPORATION FOR SMALL BUSINESS INVESTMENT (COSBI) OFFERS AN EFFECTIVE METHOD FOR MOVING MESBIC FUNDING OUT OF THE FEDERAL BUDGET AND INTO THE PRIVATE MARKETS. THIS COMMITTEE HELD HEARINGS ON THE COSBI LEGISLATION LAST YEAR, AND MANY MEMBERS OFFERED A GREAT DEAL OF SUPPORT FOR THE BILL. WE HOPE TO MAINTAIN AND BUILD ON THAT SUPPORT AS WE WORK ON COSBI DURING THIS SESSION OF CONGRESS.

COSBI FUNDINGS AND REGULATIONS OF THE MESBIC INDUSTRY IS EXPECTED TO OFFER MANY OF THE BENEFITS OF GOVERNMENT FUNDING AND REGULATION IN ADDITION TO MANY NEW BENEFITS. THE COMBINED SHAREHOLDER-ELECTED/PRESIDENTIALLY APPOINTED BOARD WILL OFFER VENTURE CAPITAL EXPERIENCE AND PUBLIC INTEREST REPRESENTATION. THE STABILITY OF FUNDS IS EXPECTED TO BE IMPROVED BY REMOVING THE INDUSTRY FROM ITS RELIANCE ON THE ANNUAL APPROPRIATIONS PROCESS. A LICENSING PROCESS, AND MONITORING AND AUDITING FUNCTIONS, WILL BE DEVELOPED FOR THE CORPORATION THAT WILL CONTINUE TO SERVE THE PUBLIC POLICY GOALS ACHIEVED BY THE SBA REGULATION OF THE INDUSTRY, WHILE FITTING INTO THE PRIVATE SECTOR FUNCTIONS OF THE CORPORATION.

AS A RESULT OF THESE CHANGES, THE SMALL BUSINESS INVESTMENT COMPANY INDUSTRY, AND THE SMALL BUSINESSES IN WHICH IT INVESTS, WILL BE BETTER SERVED. MESBICS WILL OPERATE IN A MORE STABLE REGULATORY ENVIRONMENT WITH GREATER ACCESS TO CAPITAL MARKETS THROUGH A FINANCIAL INTERMEDIARY DESIGNED TO MEET THE UNIQUE NEEDS OF SBICs. COSBI WILL PROVIDE ACCESS FOR SMALL BUSINESSES TO THE MAJOR CAPITAL MARKETS, INCREASING THE FLOW OF CAPITAL TO SMALL BUSINESSES BY MANY HUNDREDS OF MILLIONS OF DOLLARS PER YEAR.

IN ADDITION TO THE IMMEDIATE CONCERN I HAVE EXPRESSED RELATIVE TO THE BUDGET APPROPRIATIONS AND COSBI, NAIC ALSO HAS TWO OTHER LEGISLATIVE INITIATIVES TO GIVE EMPHASIS:

- 1) IN TERMS OF CAPITAL FORMATION ISSUES, NAIC SUPPORTS A TECHNICAL CHANGE IN THE TAX REFORM LEGISLATION THAT WOULD RETURN BAD DEBT RESERVES TO MESBICs AND SBICs. AVAILABILITY OF THE RESERVE METHOD IS PARTICULARLY IMPORTANT TO NEW MESBICs THAT DO NOT AS YET HAVE AN ESTABLISHED BAD DEBT EXPERIENCE. ABSENT THE AVAILABILITY OF THE RESERVE METHOD, THEIR INCOME WILL BE SUBSTANTIALLY DISTORTED IN THE EARLY YEARS OF THEIR EXISTENCE. THE BAD DEBT RESERVE WAS MAINTAINED FOR SMALL BANKS IN LAST YEARS TAX REFORM, AND WE BELIEVE THAT THE SAME PRINCIPAL THAT APPLIED TO THEIR BEING EXCEPTED WOULD ALSO APPLY TO MESBICs AND SBICs.
- 2) NAIC SHARES MOST OF AMERICA'S CONCERN REGARDING OUR COUNTRY'S INTERNATIONAL COMPETITIVENESS. AS THE LEADING SECTOR FOR NEW TECHNOLOGY AND JOB CREATION, WE BELIEVE SMALL BUSINESS SHOULD PLAY AN IMPORTANT ROLE IN ANY INTERNATIONAL COMPETITIVENESS INITIATIVES. ONE PROPOSAL WE SUPPORT, AS INITIATED BY THE SMALL BUSINESS LEGISLATIVE COUNCIL, IS THE MAINTENANCE OF UPDATED INFORMATION ON ENTREPRENEURSHIP AND THE ECONOMY. STANDARD INDUSTRIAL CLASSIFICATION (SIC) CODES ARE CURRENTLY UPDATED AT 15 YEAR INTERVALS, AND QUICKLY BECOMES OUT OF DATE ESPECIALLY IN THE RECENT TECHNOLOGICAL ENVIRONMENT. THIS PREVENTS US FROM HAVING UP TO DATE INFORMATION ON ENTREPRENEURIAL TRENDS AND PUTTING OUR FUNDS WHERE THEY WILL ACHIEVE THE MOST IN ESTABLISHING NEW MARKET NICHES AND MAINTAINING OUR WORLD COMPETITIVENESS. WE WANT TO BE

ABLE TO IDENTIFY AND INVEST IN THOSE COMPANIES THAT WILL KEEP AMERICA ON THE CUTTING EDGE OF NEW TECHNOLOGY AND THUS COMPETITIVE. TOWARD THIS END, WE SUPPORT A METHODOLOGY FOR DEVISING A CODIFICATION SYSTEM WHICH COULD ACCOMMODATE AN EVOLVING ECONOMIC STRUCTURE WITHOUT THE NECESSITY OF PERIODIC UPDATES.

NAIC MEMBERS CONTINUE TO BE AGGRESSIVE INVESTORS ENHANCING THE FLOW OF VENTURE CAPITAL DOLLARS PRIMARILY TO MINORITY OWNED BUSINESSES; AND, WE ARE THE ONLY ORGANIZED SOURCE OF THIS TYPE FINANCING. TO DATE, THE SUCCESS OF THIS PROGRAM IS IN LARGE MEASURE DEPENDENT UPON THE AVAILABILITY OF LEVERAGE CAPITAL. THE ADMINISTRATION BUDGET PROGRAM, IS ACCEPTED, WHICH SEVERELY RESTRICT THIS MUCH NEEDED PROGRAM.

I THANK THE COMMITTEE FOR THIS OPPORTUNITY TO PRESENT THE MESBIC INDUSTRY'S LEGISLATIVE INITIATIVES, AND WOULD BE HAPPY TO ANSWER ANY OF YOUR QUESTIONS.



National Association of Manufacturers

TESTIMONY OF
MARCUS GRIFFITH
PRESIDENT, THE HAIRLOX COMPANY
WASHINGTON, D.C.
ON BEHALF OF
THE NATIONAL ASSOCIATION OF MANUFACTURERS
BEFORE THE SENATE COMMITTEE
ON SMALL BUSINESS
FEBRUARY 25, 1987



TESTIMONY OF
MARCUS GRIFFITH
PRESIDENT, THE HAIRLOX COMPANY
WASHINGTON, D.C.
ON BEHALF OF
THE NATIONAL ASSOCIATION OF MANUFACTURERS
BEFORE THE SENATE COMMITTEE
ON SMALL BUSINESS
FEBRUARY 25, 1987

Mr. Chairman and members of the Committee, I am Marcus Griffith, President of The Hairlox Company, a manufacturing firm in Washington, D.C., which employs 38 people. I am testifying today on behalf of the National Association of Manufacturers as a member of its board of directors, and its Small Manufacturers Forum.

NAM is an organization of 13,500 corporations--9,000 of which are small business--located in every state and involved in the spectrum of manufacturing enterprises. NAM members employ 85 percent of the nation's industrial workers and produce more than 80 percent of the nation's manufactured goods. NAM is affiliated with an additional 158,000 businesses through its Associations Council and the National Industrial Council.

Over 40 of the NAM Board members are small manufacturers employing less than 250 employees. Additionally, the policies of NAM are reviewed by a five-member Small Manufacturers Steering Committee before final passage by the full Board, to insure compatibility with the views of small manufacturers.

Mr. Chairman, on behalf of all our members, I would like to thank you for this opportunity to express our opinion on the small business agenda for the 100th Congress.

More than ever before, the global economy in which we live has become radically more competitive. More than ever before small manufacturers need to participate in that global economy, yet are confronted with problems that have a geometrically greater impact on them than those confronted by larger corporations.

When one looks at the large picture, we see a consumption-oriented economy and huge federal deficits fueling trade deficits. In turn, federally-imposed regulations and inadequate investment incentives restrict our ability to grow, produce, and create new jobs.

I am not here to plead for special programs for small manufacturers.

I am here to suggest that small business deserves a level playing field in the game of international trade, as well as a level playing field in the area of production.

I. NAM's 12 Point Competitiveness Agenda

The National Association of Manufacturers has developed a twelve-point program we believe will help this country become more productive and competitive, a program which I have attached to my written testimony.

Many of these recommendations are quite consistent with the recommendations of the White House Conference on Small Business, reminding all of us that many economic issues are neither "big business" nor "small business" issues.

I would like to quickly summarize some of these recommendations and then elaborate on one or two that I believe have a particular impact on small businesses and ought to be a top priority for this Committee.

o REDUCTION OF THE FEDERAL DEFICIT through an aggregate freeze on spending for FY 88 and continued efforts to achieve the

Gramm-Rudman-Hollings targets;

o ADJUSTMENTS TO THE EXCHANGE RATE SYSTEMS, including bilateral negotiations with countries where there has been no improvement; strengthened coordination of international economic policy, and examination of a new exchange rate system within IMF.

o A STRENGTHENED U.S. TRADE CLIMATE, by continuing GATT negotiations; pursuing a free-trade agreement with Canada; establishing a joint business-government market development program focused on Japan; insisting that foreign governments remove trade barriers; cutting back the export control list; opening foreign telecommunications markets to U.S. products; clarifying the Foreign Corrupt Practices Act; protecting U.S. patents and intellectual property; tightening U.S. laws against imports that threaten national security; and improving the U.S. escape clause and antidumping laws.

o IMPROVED CORPORATE PERFORMANCE, by reducing costs, improving quality and services, encouraging employee commitment to competitiveness, devoting more to R&D, and marketing more aggressively abroad.

o REDUCED GOVERNMENT REGULATION AND MANDATED COSTS. Take action on product liability laws and the regulatory structure in general.

Avoid costly new mandated benefits programs that will simply shift social costs onto the backs of companies struggling to compete. This proposal will be especially harmful to small businesses because of the increased costs and loss of productivity.

- o PROMOTION OF INCREASED SAVINGS AND INVESTMENT in the U.S. by liberalizing IRA deductibility and eliminating depreciation from the alternative minimum tax.

- o ENCOURAGEMENT OF TECHNOLOGY AND INNOVATION. Accelerate defense R&D spin-offs; increase industry access to results of federal R&D; provide greater protection for U.S. intellectual property; and put a high priority on advanced manufacturing techniques.

- o CREATIONS OF A MORE STABLE FINANCIAL ENVIRONMENT through various methods to give shareholders a better chance to examine hostile takeover attempts.

- o IMPROVED U.S. EDUCATION AND TRAINING system through increased cooperation between government, business and academia through various measures.

- o AN INDICATION OF THE STRONG COMMITMENT TO COMPETITIVENESS, shown by consolidating the government's trade offices into a single

department of trade, and subjecting all new government policies to a competitiveness "litmus" test.

These are the elements of NAM's program, and are based on a survey of NAM Directors, on the established policies of the NAM and on the work of the staff. They provide a general overview of what we believe needs to be done.

II. Issues of Particular Importance to Small Manufacturers

But I would like to elaborate on a number of issues which I believe are particularly important to the small manufacturing community. These are views based upon my 37 years as a small businessman, as Founder and President of my own small company, as an NAM Board member, elected delegate to the White House Conference on Small Business, President of the D.C. Chamber of Commerce and member of the U.S. Chamber of Commerce Small Business Council.

Take the issue of product liability reform. This issue, cited four times in the 60 recommendations of the White House Conference on Small Business is a critical one for small manufacturers. It is important that Congress enact a U.S. product liability reform bill to reduce insurance premiums and settlement costs. These costs are substantially higher than those in other countries, with 1984 costs

for product liability suits in the United States totaling \$56 billion.

The costs have had a significant impact on smaller businesses. A U.S. Department of Commerce study, for example, indicated that product liability costs for machine tool builders in the United States, a small business-dominated industry sector, are 20 to 100 times greater than for those in Japan or Europe. As a result, there are now 50% fewer machine tool builders in the United States than there were a decade ago.

We might also consider the White House Conference's Number 2 recommendation: opposition to mandated benefits. The legislation which has been proposed would require a small business to provide 16 weeks of unpaid parental leave and 26 weeks of unpaid medical leave to its employees.

Such a policy has the potential to be devastating to the small businesses that are driving the creation of new jobs. One of my small manufacturing colleagues on the NAM Board, Jay Wilson of Baltimore, last week testified before the Senate Subcommittee on Children, Family, Drugs and Alcoholism, and offered the analogy that small businesses are like a baseball team with only 9 players, one deep at each position.

My own company, for example, has one accounts payable clerk, one payroll clerk, one person who doubles as a stockroom and shipping cler, one person who doubles as a word processor operator and mailing clerk, one artist, one janitor, only two mixers when we really need four, and only two skilled operators of the most sophisticated machine in our plant, without which our production will be severely affected.

One of these skilled operators happens to be a young woman who got married two months ago. Should this young woman go out on maternity leave and the proposed mandated benefits legislation become law, my cost of production in this vital segment of my business will be doubled.

These people require training for the specifics of their job. For each person on leave, we will be paying double employment costs: insurance and pension for the person and his or her replacement. We also have to conduct a search, hire, and train the replacement worker, risk decreased productivity during training, and then pay unemployment compensation for the replacement worker when he or she is dismissed--all of which assumes we can find a substitute worker in the first place.

Regulations already in place cost American manufacturers, American consumers, and give the edge to foreign competitors. For example, it

costs \$3900 to ship a truckload of blue jeans from El Paso to Dallas, but only \$2500 to \$3000 to ship the same quantity from Taiwan to Dallas. Similarly, it costs \$135 to ship ball-point pens from Taiwan to Kalamazoo, Michigan--the same shipment from Chicago to Kalamazoo costs \$178.

Is it any wonder that small manufacturers are being beaten over the head by the ability of foreign competitors to undercut our prices?

Finally, I want to touch briefly on the subject of international trade. Small business owners frankly do not export enough of their products, more likely than not because of the fear of the unknown. Although I am small by anyone's standards, with only 38 employees, exports make up about 20 percent of my business, and it is growing rapidly.

Yet, the complexities of international trade are great enough to discourage even someone familiar with the processes. A recent sale to the country of Guinea involved four countries, five financial institutions and many other entities and institutions.

Besides the buyer in Sierra Leone, who financed the transaction through an investment company in Gibraltar which used a London bank, which in turn used two American banks, the other entities involved

were the ocean carrier, the surface carrier, the inspecting agent who inspected the goods for conformity with the purchase order, the inspecting company which issued the required inspection certificate, the insurance broker, the insurance underwriting company, and finally the Department of Commerce which was required to certify that the goods were of U.S. origin.

It is a fair estimate that no fewer than 100 telephone calls were made, 20 telexes sent, and 10 letters dispatched. Four o'clock a.m. telephone calls to compensate for the five hour time differential between London and Washington were the norm for the transaction. Yet despite our best efforts, the letter of credit for the order expired and became a collection instrument which involved more negotiations and a delay in payment of nearly 60 days.

Ladies and gentlemen, for a new company interested in exporting their goods, the obstacles can seem insurmountable.

The time has come for Congress to cut the Gordian knot of international trade regulations binding American exporters. A good first step, supported by the NAM and the White House Conference on Small Business, would be to consolidate our trade operations into a "one stop" U.S. Department of Trade. Also, reform of the Foreign Corrupt Practices Act would make it significantly easier for small

manufacturing operations to seek and maintain legitimate business opportunities overseas.

We also must insist that foreign governments remove their unfair trade barriers and discontinue unfair practices. Further, we must reform Section 301 of the Trade Act to give the U.S. Trade Representative more power to act directly against foreign unfair policies,

Clearly, Mr. Chairman, this is a full plate and I do not envy the task which remains before you.

But if Congress is serious about American competitiveness, then it must take the necessary steps to level the playing fields in trade and production.

When that is done, America's small manufacturers will take the chances necessary to compete, to succeed, or even to fail. But Congress and the Administration must take the action needed to clear the decks and give us a running start in the competitive race we are all in.

COMPETING IN THE GLOBAL ECONOMY

Contents

The World Has Become More Competitive

Where the United States Stands Competitively

The U.S. Trade Crisis

Longer Term Competitive Problems

A Strategy for Competitiveness

1. A National Commitment to Competitiveness
2. Manufacturing is the Key
3. Reducing the Budget Deficit
4. Exchange Rate Adjustments
5. Strengthening Trade Policies & Promoting Exports
6. Toward Greater Corporate Competitiveness
7. Reducing Government Regulatory & Mandated Costs
8. Increasing Savings and Investment
9. Encouraging Technology and Innovation
10. A More Stable Financial Environment
11. Education & Training
12. A Standard of Competitiveness

Building on Strength

Jerry J. Jasinowski
Executive Vice President
National Association of Manufacturers
February 6, 1987

-1-

The World Has Become More Competitive

Today we live in a global economy that has become radically more competitive:

- One-fifth of our economy is directly involved in international trade, and over 70 percent of products we produce have to compete with foreign goods.
- Tough new competitors have emerged from the Pacific Basin to South America. They have the capital and the technology to compete across the industrial spectrum. They have the advantage of a lower wage base, in many instances dramatically lower. More importantly, these countries have organized themselves with the conscious goal of being successful international competitors, and they do not always play by the rules we recognize.
- Instead of the supply shortages predicted by the Club of Rome, we now have a world economy characterized by excess supplies in many industrial materials, commodities and goods. As countries try to maintain their standard of living by exporting more, global over-supplies in a deflationary environment will further increase competition.
- International capital movements and fluctuating exchange rates have become primary determinants of the cost structure and trade position of most countries. Given the importance of the dollar to the world financial system and the growth of world debt with its associated export imperative, there are strong incentives for countries to manipulate their currencies in search of competitive advantage.

Where the U.S. Stands Competitively

Competitiveness is a term that is on everyone's lips, but what it means and where the United States stands is a matter of vigorous debate. Some say the United States is as competitive as it has always been. Others suggest we are facing a competitive crisis.

To compete means to strive or contend against others for profit or prize. For a nation, competitiveness is the ability to match ourselves against other nations economically. There are six broad criteria for measuring how well a nation competes: economic growth, price stability, employment, efficiency, the merchandise trade balance, and the broader balance of payments on current account.

While the U.S. economy has performed well by many domestic criteria--economic growth, price stability, and employment--it has performed poorly in terms of our external balances. With these considerations in mind, the President's Commission on Industrial Competitiveness defined competitiveness in the following way:

"Competitiveness is the degree to which a nation can, under free and fair market conditions, produce goods and services that meet the test of international markets while simultaneously maintaining or expanding the real incomes of its citizens."

This is an appropriate definition for two reasons: it emphasizes that today's economic competition is international, and it sets the objective of improving or maintaining our standard of living. While we could compete by lowering the American standard of living, that is a prescription for failure.

Recent U.S. economic performance has failed to meet this test of competitiveness. While the U.S. still has the strongest economy in the world, the day of unquestioned American preeminence may be over. Last year we had a trade deficit of \$170 billion, the largest in our history. We have become the world's largest debtor nation. Our overall productivity performance and other measures of long-term competitiveness are inadequate relative to the competition we face.

The U.S. Trade Crisis

The evidence that the U.S. is too frequently a loser in international competition is overwhelming:

- Capped by a record \$170 billion trade deficit last year, our cumulative trade deficits since 1983 exceed \$500 billion.
- Roughly two million manufacturing jobs have been lost since 1980 as a result of our huge trade deficits.
- Last year the U.S. experienced a deficit in high technology trade for the first time in its history.
- It is estimated that by 1990 the interest on our foreign debts will amount to 5 percent of America's industrial output. Paying for this debt will divert funds that could be used to build productive capacity for the future, and may well "...reduce the annual rate of increase of real income in the U.S. over the next five years by between half a percent a year and one percent a year," according to Martin Feldstein.

The implications of these developments for America's standard of living are worrisome, but do they add up to a crisis? NAM's Board of Directors thinks they do. Few of the questions that were put to NAM's directors in a competitiveness survey distributed in September 1986 got the same answer from a majority of the respondents. One of those that did was the question: Do you believe that America's flagging competitiveness, characterized by a trade deficit of \$170 billion, constitutes a national crisis? Almost all of them said yes.

Important as it is to recognize a crisis, it is just as important to understand its causes. The U.S. shift from a manufacturing trade surplus to an enormous deficit in just a few years deserves emphasis because it indicates that the cause is not the character of the American work force or American management. The current trade crisis has been due primarily to macro-economic mismanagement and adverse conditions consisting of extremely high exchange rates for the dollar, unusually high consumption centered growth in the U.S., slow growth abroad, and huge U.S. budget deficits.

Longer Term U.S. Competitiveness Problems

In addition to mounting trade deficits, there have been disturbing signs of a decline in this country's ability to compete in world markets:

- For over a decade, U.S. productivity has consistently grown more slowly than that of our competitors. From 1977 through 1983, America's manufacturing productivity grew one half as fast as Germany's and one-third as fast as Japan's. Although U.S. manufacturing productivity growth has improved substantially in the last couple of years, it still lags behind such growth by our major competitors, and our non-manufacturing productivity growth is dismal.
- Capital formation in the United States has consistently been a lower proportion of GNP than in other major industrial countries.
- Although civilian research and development has been increasing in certain sectors of the economy, as a percentage of GNP, research and development spending still lags behind Germany and Japan.
- Despite the improvements made in firm competitiveness, NAM directors concluded that roughly half of the improvements we need to become more competitive will have to come from new initiatives by U.S. companies.
- The U.S. has broad cultural attitudes that do not place sufficient emphasis on competing internationally--in our educational institutions, among government leaders, with our workers, and the public in general.

A STRATEGY FOR COMPETITIVENESS

As the nation moves to establish improved competitiveness as a national priority, the steps to achieve that goal will be debated and refined. There is no single, quick-fix solution. We do understand the problem reasonably well, however, and we know many of the steps that should be taken.

What we need to do now is to forge a coherent strategy for competitiveness from the array of public and private actions that will have to be taken. The only strategy that will work is one that depends upon and encourages individuals to strive for excellence, that recognizes the need for teamwork, and that utilizes the strengths of the free-market system. Finally, it is a strategy that will depend upon our ability to create new comparative advantages from creative cooperation between government and the private sector. At the least, a more intelligent and supportive government role will be required in many areas, such as technology transfer, regulatory reform, exchange rates and trade policy.

The following 12 points are the major practical elements of such a strategy. They are, of course, only a beginning.

1. A National Commitment to Competitiveness

Historically, the United States has focused most of its energies and resources on domestic economic and social concerns and national defense. Given the realities of the global competition we now face, however, keeping America competitive will have to be a priority second-to-none.

We need to understand that competitiveness relates to the society as a whole. It is societies that compete for living standards, security, power, and prestige--not just governments, nor firms, nor workers. Any discussion of American competitiveness that is not concerned with our values and priorities as a society will miss the mark.

Virtually all NAM Directors believed that the single most important thing that could be done would be a commitment to competitiveness on the part of the President. This can serve to focus the attention and resources of our nation on this critical problem in much the same way that President Kennedy's commitment to putting a man on the moon did for an earlier generation.

Such a commitment requires specific goals. One goal broadly supported by our directors is a trade surplus through competitiveness in five years. Given estimates that by 1990 the United States will owe half-a-trillion dollars to foreigners, we are going to need a trade surplus just to pay our bills.

Such a commitment also requires a consensus by everyone. That will not just happen. It is going to take a lot of consensus building first. Consensus building is difficult, but the new Council on Competitiveness, chaired by John Young and supported by the NAM, is a key mechanism for bringing business, labor, and universities together.

2. Manufacturing is the Key

NAM Directors were nearly unanimous in their view that greater recognition should be given to the role of manufacturing in trade and competitiveness. Roughly four-fifths of the U.S. trade deficit is in manufactured goods, which means that we must compete through manufacturing. Finally, others, too, are beginning to emphasize that manufacturing is the key to U.S. international competitiveness:

"American performance in manufacturing is going to set the country's standard of living as it struggles out of its gigantic trade deficit."
WASHINGTON POST

"Our strength in trade depends upon our strength in manufacturing."
NATIONAL JOURNAL

The Chairman of the Federal Reserve, Paul Volcker, goes a step further, suggesting that manufacturing output will have to grow 30 percent over the next five years to correct our trade imbalances. In a speech at Yale University, he concluded that manufacturing industry is going to have "...a lot more to do with the basic health of the American economy and the American nation."

Manufacturing is central to U.S. economic development for reasons beyond trade. For example:

- Manufacturing is the primary arena for technological innovation.
- Manufacturing productivity gains are three times greater than in the service area and the general economy.
- Manufacturing is the primary creator of demand for services. "If your manufacturing industries go down the drain, most of the service industries will go down with them."

LESTER THUROW

Given that we have overlooked the contribution manufacturing can make to our international competitiveness and economic health, a joint Congressional Resolution emphasizing the importance of manufacturing to the economy is merited.

3. Reducing the Budget Deficit

The single most important public policy step that could be taken to reduce the U.S. trade deficit is to reduce the budget deficit, NAM Directors said. This conclusion agrees with economic analyses showing that budget deficits and macro-economic imbalances have dramatically increased the trade deficit in three major ways:

- U.S. budget deficits have raised real interest rates, the primary factor responsible for capital inflows and the overvaluation of the dollar. The rise in the structural budget was responsible for approximately two-thirds of the appreciation of the dollar from 1982-85.
- U.S. budget deficits raised the U.S. growth and consumption rates substantially above our competitors, dramatically increasing the flow of imports into the United States.
- Budget deficits have also raised the cost of capital in the U.S., making it more difficult for capital intensive firms to compete internationally.

While budget deficits must be reduced, care must be exercised so that economic growth is not sharply depressed. Three steps are appropriate:

- Continued efforts to restore the automatic mechanism of Gramm-Rudman and to adhere to the targets for deficit reduction.
- An aggregate freeze on federal spending for fiscal 1988 to equally distribute the pain of deficit reduction.
- And the maintenance of a monetary policy that supports continued economic growth.

In addition, a bipartisan Economic Summit should be considered by the Administration and Congress. The purpose of such a summit would be to reconcile divergent priorities attached to entitlements, Social Security, national defense, and tax policy. All major components of the budget would be on the table.

4. Exchange Rate Adjustments

"The primary reason for our deteriorating trade imbalance was the 70 percent rise of the dollar that occurred between 1980 and the spring of 1985. This unprecedented increase in the dollar dramatically increased the price of American products relative to foreign products, causing the volume of U.S. exports to decline while merchandise imports have increased by nearly 50 percent." MARTIN FELDSTEIN

NAM Directors agreed that exchange rate adjustments were an area of public policy where trade competitiveness could be substantially improved.

While there has been significant progress with respect to improving the exchange rate of the dollar with Japan and Western Europe, little progress has been made with respect to the currencies of our other major trading partners. The following steps would improve exchange rate conditions and stability:

- Reduce federal budget deficits in order to lower interest rates that artificially hold up the value of the dollar.
- Conduct vigorous bilateral negotiations with countries where there has been no exchange rate improvement, such as Taiwan, Korea, and Hong Kong. The Canadian dollar and the Latin American currencies have also not appreciated against the dollar. Further thought and attention are required respecting these currency relationships.
- Make further efforts to strengthen the coordination of international economic policy among the major industrialized countries, in part to stabilize exchange rate fluctuations, but in the current context also to encourage Germany and Japan to pursue policies that will achieve higher levels of growth.
- Explore the possibility of establishing a new exchange rate system within the IMF surveillance framework. Although a fixed-parity Bretton Woods system seems unattainable under present conditions, other alternatives should be explored. The U.S.-Japan "target zone" experience should be carefully monitored for lessons for the future.

5. Strengthening Trade Policies and Promoting Exports

NAM Directors believe that we need to act in three broad ways: to improve the international trading system and access to foreign markets, to boost U.S. exports, and to enhance the effectiveness of U.S. import laws.

Government needs to look at the trading system as it affects U.S. manufacturers and take the following actions:

- Press other GATT countries for meaningful improvements in the GATT in the context of the Uruguay Round of Multilateral Trade Negotiations. Congress should enact this year negotiating authority that gives U.S. negotiators the strongest possible hand.
- Pursue vigorously a free-trade-area agreement with Canada that advances the economic interests of U.S. industry.
- Establish a joint business-government market development program targeted on Japan and modeled on the highly successful Market Development Cooperation Program, which was established by the Agriculture Department in the 1950s. The costs should be shared by government and the private sector.
- Insist that foreign governments remove their unfair trade barriers and discontinue their unfair practices. To this end, Section 301 of the Trade Act should be improved and the U.S. Trade Representative given more power to act directly against foreign unfair policies. Executive Branch discretion under this statute, however, should be retained.

U.S. export policies constitute the second major area of concern. As soon as possible, government should:

- Cut back the export control list by 10 to 15 percent and otherwise work to lessen the burden of U.S. export controls. The National Academy of Sciences has estimated that national security export controls alone inflict an annual cost of \$17 billion on the U.S. economy.

- Offer American companies the financing support they need to make them competitive with foreign manufacturers that benefit from effective and determined government financing programs. EximBank funding should be based on a realistic assessment of U.S. industry needs, bearing in mind that America's strength as a major international producer of capital goods is largely dependent upon financing. Mixed credits, similar to those provided by our competitors, should be utilized.
- Undertake new efforts to open foreign telecommunications markets to U.S. products.
- Enact legislation clarifying the provisions of the Foreign Corrupt Practices Act so that U.S. companies do not lose legitimate business opportunities overseas.

U.S. policies on imports also need a new look. Government should fully enforce our existing trade laws and should at least make the following improvements in those laws:

- Amend Section 337 of the 1930 Tariff Act so that U.S. owners of patents and other intellectual property do not have to meet essentially irrelevant economic tests in order to protect themselves from infringing imports.
- Improve the U.S. escape clause. U.S. industries being hammered by imports and other difficulties should not have to prove that imports are the biggest problem facing them to get import relief. The law should be made more effective for those who find themselves in critical circumstances.
- Review U.S. antidumping law with the aim of making prudent and effective improvements. The current antidumping law is inadequate, but some of the recommendations that have been offered to amend it would do more harm than good. These kinds of suggestions must be rejected, but the search for positive antidumping reform must continue both in the Congress and through U.S. participation in multilateral negotiations.
- Tighten U.S. law against imports that threaten national security. Section 232 of the Trade Expansion Act should be changed so that petitioners are assured of Administration responses to their petitions within a definite period.

6. Toward Greater Corporate Competitiveness

Improving our ability to compete at the corporate level is crucial because that is where we make and sell the products. Enormous progress has been made, which belies the notion that U.S. corporate competitiveness is declining. Manufacturing productivity has risen sharply since 1980 and U.S. multinational manufacturing firms have maintained or increased their share of world export markets:

"If we wish to explain our national trade problems, we should look for reasons other than the decline of our companies' technology and management. We should be asking whether developments and policies specific to the United States have been making the country less attractive as a location for manufacturing."

(Economists) LIPSEY and KRAVIS

Notwithstanding this point, NAM Directors felt that, depending upon the industry, 25 to 50 percent of the improvements in international competitiveness will have to come from changes in corporate policies and practices. The priorities for achieving further gains were:

- Reduce further corporate costs at all levels by corporate restructuring, reducing employee costs, improved materials and inventory management, improved work rules and efforts to increase productivity.
- Continue to improve quality and services by listening to the customers and taking actions to increase value and differentiate yourself from competitors.
- Improve the manufacturing process by elevating the corporate priority given manufacturing. Greater emphasis should be put on making the right hardware and systems decisions necessary to achieve a sustainable manufacturing advantage. NAM's new video program, "Competing Through Manufacturing," illustrates the importance manufacturers place on this area.

- Gain a greater employee commitment to competitiveness by sharing information, recognizing that people are the main source of ideas and productivity gains, gaining acceptance of more flexible work rules, providing positive reinforcement for successes, and developing a team pride in the organization.
- Greater research and development investment, the encouragement of innovation throughout the organization, and the more rapid development of new products.
- And market more aggressively abroad, through a stronger export orientation, and by establishing production facilities abroad to serve foreign markets.

Restructuring the corporation is a part of many of the above priorities, and, therefore, it is an important aspect of what corporations are doing to become more competitive. Although large mergers have received a lot of attention, a more important trend has been divestitures as corporations strive to sharpen their competitive focus in order to cut costs and gain market share. This has also meant a much more aggressive marketing and sales program.

7. Reducing Government Regulatory and Mandated Costs

NAM Directors believe that one of the most important things that government can do to improve productivity and international competitiveness is to reduce government imposed regulatory and mandated costs. All new proposals should be evaluated in terms of their costs and benefits relative to international competitiveness. There are several important actions that can be taken in this area:

- Enact a U.S. product liability reform bill to reduce insurance premiums and settlement costs, which are substantially higher than those in other countries. 1984 costs for product liability suits in the United States were \$56 billion.
- Deregulate the trucking industry. This could reduce business costs by over \$50 billion.
- Avoid shifting government costs to the private sector. Government should not mandate new social programs that business will have to pay for such as comparable worth, family and medical leave, and new health benefit programs.
- Analyze carefully new proposals for acid rain controls and seek alternatives that would not disproportionately raise electricity and manufacturing costs.
- Reform the antitrust laws by recognizing the reality of international competition. Antitrust actions should be limited to actual damages. Sections 7 and 8 of the Clayton Act should be amended. It is important to distinguish between pro-competitive mergers and other mergers, and the unwarranted restrictions on interlocking directorates should be removed.
- Take a new look at the Federal regulatory structure with a view to eliminating unnecessary regulations and improving the cost-effectiveness of those that are needed.

8. Increasing Savings and Investment

The U.S. is a high-consumption, low-saving, and investment society, and this hurts our ability to compete with other nations, NAM Directors said. The U.S. propensity to consume and import is much higher than our competitors. The American savings rate is the lowest among industrial nations and has recently fallen to the unprecedented low of 2.8 percent of disposable income. This low saving rate, seriously aggravated by government dissaving associated with government deficits, contributes to the overvaluation of the dollar and reduces the funds available for investment. Recent tax changes have greatly aggravated the problem by encouraging consumption spending while penalizing saving and investment. Taken together, these factors reduce our productivity growth and our ability to compete in world markets.

Several steps can be taken to increase national saving and investment:

- Reduce the budget deficit, thereby freeing more savings for productive investment.
- Liberalize IRA deductibility and reduce taxation on interest earnings.
- Eliminate depreciation from the alternative minimum tax and review other alternatives for encouraging investment, such as a limited investment tax credit for machinery used directly in manufacturing.
- Begin in earnest the national debate on the merits of a broad-based consumption tax, such as a value-added or business transfer tax. Taxes of this type would have the benefits of increasing private saving, reducing the public dissaving associated with the budget deficit, and improving American competitiveness through rebatability on exports. Canada and Japan, our largest trading partners, are considering joining 44 other nations which use a form of value added tax.

9. Encouraging Technology and Innovation

While the U.S. continues to be the world's leader in the development of new technologies, U.S. industry is often slower than its competitors in commercializing new technology. NAM Directors felt action should be taken to encourage more rapid commercialization of technology. The bulk of this problem must be dealt with by the private sector, but there are several steps government can take to maintain our comparative advantage in technology and innovation:

- Accelerate defense R & D spin-offs and allocate more of our Federal spending on research and development to non-defense efforts.
- Put a high priority on developing and disseminating technology on advanced manufacturing techniques. Federal laboratories can be encouraged to conduct research in areas such as that performed by the National Bureau of Standards in its Automated Manufacturing Research Facility. Additional public and private funding could be provided for the expansion of the National Science Foundation's programs in engineering and manufacturing technology, such as the Engineering Research Centers and the Industry/University Cooperative Research Centers.
- Increase industry access to the results of Federal research and development activities. The capabilities of the National Technical Information Service to inform manufacturers of the availability of government-developed research results could be expanded. In addition, there should be full implementation of the the Federal Technology Transfer Act of 1986. This is designed to establish cooperative efforts between the government laboratories and the private sector to bring the results of government research to commercial reality.
- Increase funding for science and technology education, particularly to those universities and colleges willing to establish departments of engineering and manufacturing technologies. More students should be encouraged to pursue careers in these fields.
- Provide greater protection for U.S. intellectual property both at home and abroad. It is imperative that effective action be taken to deter piracy and counterfeiting of U.S. products and processes. This means greater protection for commercial information, protecting copyrights and amending Section 337 of the Tariff Act to ensure that foreign exporters do not violate U.S. patents.

10. A More Stable Financial Environment

Foreign competitors, such as Japan, often outperform the U.S. because their financial system encourages greater stability and a longer-term perspective. Acquisitions and divestitures are sometimes important ingredients for becoming more competitive, but in too many cases hostile takeovers divert attention from the longer-term actions needed to improve the competitiveness of firms. Some of these actions only increase debt burdens and make a few players extremely wealthy. The following minimum actions would improve financial stability by giving shareholders and management time and information to make intelligent decisions on hostile takeovers:

- Lower the notification threshold for announcing an intention to acquire a company from 5 to 2 percent.
- Extend the time period for tender offers from 20 to 45 days.
- Require raiders to notify the target shareholders of an acquisition immediately by shortening the 13 (d) ten-day window to a period of two or three days.
- Halt the circumvention of the Williams Act by schemes that use the tender offer process to acquire shares after the tender offer is terminated.
- Give the Securities and Exchange Commission increased resources to pursue insider trading and other abuses.

In addition to these measures, consideration should be given to restricting "greenmail." A requirement that stocks be held for a minimum period before voting rights are granted might help as might giving shareholders of both the target and raider firms an opportunity to vote on an acquisition before it is completed. Finally, the Hart-Scott-Rodino antitrust law should be reviewed with an eye to extending the time frame and ensuring that mergers and acquisitions apply to partnerships.

11. Education and Training

An educated, skilled and motivated work force is an essential ingredient for improved competitiveness. Despite our many strengths, the quality of the U.S. labor force has suffered from inadequacies in our educational system, high illiteracy rates, poor math and science training, higher drop-out rates than in other advanced countries, and inadequate retraining and relocation of displaced workers. The following steps would begin to tackle these problems:

- Raise the standard of minimum education to ensure that all students master the basic skills necessary to function in a technological, highly competitive world.
- Modernize America's public education and training system. Businesses should be encouraged to approach training and retraining systematically and to integrate such programs into the planning and operation of the firm. The key to more relevant education and training is to focus efforts on future market demands and improve the linkage between employees and education and training institutions.
- Create a competent, versatile, systematic and voluntary approach to displaced workers and readjustment. Businesses should adopt policies to avoid displacement, such as the use of interplant transfers, reduced workweeks and job-sharing. If displacement is unavoidable, businesses could assist with job counseling, job search assistance, retraining for in-company transfers, outplacement assistance and providing as much notice as possible. Public and private sector readjustment programs should be coordinated and have the following attributes: broad coverage, easy access, simplicity, limited red tape, individual choice, cost-consciousness, flexibility and linkages with existing programs.
- Encourage cooperation by government, educational institutions and businesses to reduce illiteracy. The importance of a literate, educated work force cannot be overstated.

12. A Standard of Competitiveness

The above steps will be necessary to meet the challenge of increased international competitiveness. But we need to evaluate all of our corporate and public policies to determine how they impact our ability to compete. Three steps would assist this process:

- Consolidate the government's international trade into a single Department of International Trade & Industry.
- Require that all major government policies be subjected to a competitive impact statement to determine the positive and negative effects on our ability to compete.
- Establish a White House Council that would provide a continuing focus and leadership on national efforts to improve productivity and international competitiveness.

Building on Strength

While the U.S. faces serious competitive problems, we can meet the challenge. Our advantages are impressive and recent developments are encouraging:

- Our competitive market system allows the U.S. economy to change rapidly to renew itself and to meet new competitive tests. The dynamics of our market system are the envy of our competitors and our primary source of economic strength.
- U.S. manufacturing corporations have taken major steps to achieve and/or retain the status of world-class competitors.
- The Administration's actions on exchange rates are a major step toward improving U.S. international competitiveness.
- There is a growing recognition that manufacturing is the key to improving U.S. competitiveness.
- In the State of the Union message, President Reagan has for the first time made American competitiveness a national priority.

The challenge we now face is clear. At stake are American pride, our standard of living, and ultimately our security. The task before us is technically complex and complicated but simple in terms of purpose. Building upon America's strengths, we must do whatever we have to do to reestablish American preeminence as the most competitive nation in the world.

NAM



NASBIC

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EXECUTIVE COMMITTEE

February 25, 1987

STATEMENT OF

R. MICHAEL HAYNES

Before the

COMMITTEE ON SMALL BUSINESS

UNITED STATES SENATE

Mr. CHAIRMAN AND MEMBERS OF THE COMMITTEE:

I am R. Michael Haynes, General Counsel of the National Association of Small Business Investment Companies (NASBIC), the trade association which represents the Small Business Investment Company (SBIC) industry.

On behalf of the officers and members of NASBIC, we greatly appreciate the opportunity to express our views on the most crucial issues facing the American small business community today.

Preserving and Strengthening SBA

In common with the other major small business organizations, NASBIC over the past three years has given its highest priority to countering the Administration's threat to terminate the only agency in the Executive Branch whose sole purpose is to serve and speak out on behalf of the small businesses of our nation. Both as an efficient and effective provider of essential financial assistance to small firms, and as a symbol of the Federal Government's recognition and support of the critical role of small business to the American economy, SBA must be preserved as an independent agency. In addition, its proven financial assistance programs must be preserved, and, where possible, enhanced.

Although the Administration has apparently backed off of its proposal to terminate the SBA in its budget proposal to Congress for FY 1988, it is clear that this action was not taken without the letting of much blood, sweat and tears by the small business community. Indeed, it was only after the delegates to last year's White House Conference on Small Business -- men and women who represented every state and virtually every segment of the small business community -- voted as one of their top priorities to preserve the SBA and its essential financial programs was it that the Administration finally realized that small business would not permit such an ill-founded proposal to take effect.

But, the Administration's budget proposal is not all that it seems. Peter McNeish, the President of NASBIC, submitted a

statement to the Committee yesterday addressing our concerns on the Administration's FY 1988 budget proposal, so I won't reiterate those objections today. Let me just say, however, that there is every reason to be concerned with the current thinking of the Administration regarding the restructuring of some of the financial assistance programs at SBA -- including proposals that would seriously damage and eventually destroy the ability of SBIC and Minority Small Business Investment Companies (MESBICs) to provide meaningful assistance to small business. This Committee has stood steadfast in the past against permitting such errant proposals to take root, and we are confident of the Committee's ability to do so in the future. We stand ready to help you in any way in this effort.

We are also confident that when the nomination of James Abnor to be the next Administrator of SBA is finally submitted to and approved by the Senate, the SBA will have at its helm someone who will not only show leadership qualities, but will have the interest of the small business community at heart in his administration of the agency's programs. We at NASBIC look forward to the day -- as I'm sure do all members of the small business community -- when the void at the top of SBA is filled with a man of the character, stature and integrity of James Abnor.

CORPORATION FOR SMALL BUSINESS INVESTMENT (COSBI)

For the past four years, NASBIC and the National Association of Investment Companies (NAIC), which represents the Minority Enterprise Small Business Investment Companies (MESBICs), have each devoted a major part of their energy and resources to developing a proposal to restructure the SBIC program.

This legislative proposal, known as the Corporation for Small Business Investment (COSBI) bill, is the highest legislative priority of the SBIC industry! COSBI would be a Government Sponsored Enterprise (GSE) that would operate as a "capital bank" for the SBIC industry, and its public purpose would be to provide a reliable source of affordable long-term capital to our nation's small businesses, similar to the way Sallie Mae has provided financial support for education and Fannie Mae for housing.

COSBI would maintain the public/private partnership concept that subjects the private sector partner to total loss of its entire investment before the government would be subject to even a nickel of loss. In addition, it would provide a government oversight structure consistent with a recognition of the public purpose of the Act while at the same time recognizing the needs of the private sector not to be hampered by see-saw regulatory changes which have frequently occurred under different Administrations at SBA.

The credit for this concept, however, does not go to the SBIC industry -- but to Congress -- which twenty years ago added a provision to the Small Business Investment Act of 1958 directing

SBA to make annual recommendations to Congress "with respect to the feasibility and organization of a small business capital bank to encourage private financing of small business investment companies." We believe that this concept, crafted by Congress and fully supported by the SBIC industry, is one whose time has come!

Mr. Chairman, we are greatly encouraged by the fact that you have indicated you would reintroduce our COSBI proposal this Congress and would make it a top legislative priority of the Committee. We have gotten similar indications from the Chairman of the House Small Business Committee that COSBI will be on an equally fast-track there. We are anxious to work with you, your able staff and the other members of this Committee and the Congress in the weeks ahead to move COSBI through the legislative process and make it a reality.

Clearly, the beneficiaries of enactment of COSBI will be the small businesses of our nation who so sorely need greater access to venture capital. If this nation is to continue its competitive edge, we must ensure that the small business sector, which accounts for the vast majority of jobs created and nearly half of our gross national product, receives a fair shake when it comes to access to long term, growth capital. COSBI, we believe, will provide that "fair shake." The result will be increased venture investments flowing through COSBI that will create hundreds of thousands of new jobs in a wide variety of industries

and generate substantial tax revenues to the government -- clearly a win-win situation for both small business and the Federal Government.

We at NASBIC stand ready to help you and the Committee in any way that we can to bring about the enactment of COSBI this Congress.

Impact of Federal Tax Policy on Small Business

It is clear that many small businesses will be adversely impacted by the Tax Reform Act of 1986. Small corporations will receive smaller reductions in corporate tax rates than large corporations, and many small firms will be adversely affected by the elimination of capital gains and investment tax credits and the increase in the depreciable life of capital assets. All of these issues were recently addressed at the recent Small Business Legislative Issues Conference. NASBIC fully supports the recommendations of that Conference that the adverse impact of these recently enacted proposals should be corrected.

We at NASBIC are particularly concerned about the impact that the removal of the capital gains tax differential by the 1986 Tax Bill will have on small business and the venture capital industry. For SBICs, as for all other investors in American business, the level of federal taxation for long-term capital gains was by far the most important provision in the tax code. Unfortunately, it was eliminated even though the evidence was irrefutable that a meaningful differential between tax rates on

ordinary income and those on long-term capital gains guaranteed the essential flow of equity capital to entrepreneurs attempting to start new businesses or striving to expand their existing operations. Clearly, the capital gains differential must be restored in order to reward those investors willing to take a risk in smaller, high-potential entrepreneurial enterprises.

We believe that the Small Business Committee should serve as the forum for examining these and other tax issues that affect small business. Your Committee should serve as the forum for bringing together the best ideas on taxation of smaller and growing businesses.

Mr. Chairman, thank you for giving NASBIC the opportunity to express our views on these crucial small business issues.

Hearings of the U.S. Senate Small Business Committee, February
25, 1987

Senator Dale Bumpers, Chair

REMARKS ON SMALL BUSINESSES AND INTERNATIONAL TRADE

Prepared by:

Sherry Icenhower

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International Chair, Capital Area Chapter of the National
Association of Women Business Owners (NAWBO)

Elected Delegate and International Chair, State of Virginia, 1986
White House Conference On Small Business

Mr. Chairman:

The era of easy American advantage in the international marketplace is over. Modern management and finance, technology, and the worldwide increase in the education and skills of workers have created a global economy. This new international economy has raised standards of living around the world and opened our vast domestic markets to determined and skilled competitors. Dated views about the United States' standing in the world economy along with the fact that the U.S. is unable to sell many of its products at competitive prices on world markets are at the foundation of the current U.S. trade deficit.

According to the Office of the Management and Budget, the national debt doubled between 1980 and 1985. The American percentage of world exports shrank by nearly one third between 1960 and 1984. Even in high technology industries we have lost considerable world market shares.

Too many people are unemployed or underemployed and several of our industries are in trouble. Our ability to meet our obligations as a world leader is threatened by the erosion of the U.S. competitive position in commerce, industry and technology.

It is crucial that the 100th Congress take action to support small businesses which are the center of creativity and growth, employing nearly half of our private workforce and producing half of our gross domestic products. Small businesses created nearly two thirds of the new jobs of the last decade and have been one of the driving forces behind our advances in technology. Small businesses are one of the most powerful resources the United States has!

Allowing foreign manufactureres to win domestic markets has displaced 1.1 million American production workers since 1980. American States currently offer foreign businesses multi-millions dollars in incentives, tax exemptions or deferrals, bonds and access to credit to build manufacturing companies in the U.S. Yes, these foreign-owned plants employ Americans, but they promote a foreign product which competes with American products, and they control new technology development.

American small businesses need access to capital, credit, tax incentives and bonds to grow. It seems to me that State Governments should first offer U.S. businesses an opportunity to develop and expand before mounting expensive and massive efforts to court and attract foreign companies by offering them tremendous financial advantages on a large scale. U.S. businesses, besides employing Americans at all levels, will also

keep new technological developments in the United States growing and, by prospering, will ensure a bright future for us and our children .

I would like to encourage the U.S. to continue its policy of free and fair trade of goods and services among countries, combined with an aggressive, visible, high priority program to support and encourage small businesses to export. To successfully accomplish this I am making the following recommendations:

- . Both federal and state agencies should work closely with the private sector in developing goals and objectives to support international trade and economic development.

- . Federal and State agencies should explore joint ventures to support and increase export, trade, training and education for small businesses. Education and training should address and emphasize languages and the cultural and business customs of different countries.

- . Create a Small Business Incentive Export program similar to the successful Small Business Innovation and Research Program.

- . Improve and simplify the Foreign Sales Corporation provisions to make it more useful and viable for small business.

. Ensure representation of small businesses in all the General Agreement On Tariffs and Trade (GATT) negotiations.

. Import quotas and restraints clearly impede trade. Review those currently in existence. If they are not justifiable, remove them. If found appropriate, quotas and restraints should be enforced and maintained.

. Promote tourism to the United States, which could greatly help reduce the trade deficit. This should include developing a coherent marketing plan and then mounting a sustained and aggressive advertising and promotion campaign in the countries targeted. Tourism benefits many types of businesses such as: travel agents, airlines, transportation, hotels, restaurants, food industry, clothes industry, arts and crafts, etc. It also helps create a strong demand for American goods abroad as tourists return to their countries and look for the products they encountered, used or ate during their visit.

. Create new mechanisms and abolish existing obstacles so that major sources of long-term capital -- pension funds, IRAs, insurance companies and trusts -- are permitted and encouraged to invest in small businesses. Federal, state, and local governments should form a partnership with the private sector to increase the availability of long-term, fixed-rate loans to small businesses.

. The U.S. Department of Commerce should identify promising service areas for export and then educate, train and increase awareness among small businesses about these opportunities.

. Identify, evaluate, and adapt for U.S. and use successful export practices and procedures utilized by leading exporting countries. Official forms of support to encourage and facilitate small businesses export include: sponsorship of trade delegations abroad, assistance with shipping and letters of credit, joint ventures to spread risk, certain tax preferences, financing to cover pre-export costs and collecting receivables, establishing a public-private partnership to provide market information and analysis to the small business community, etc.

. Bring pride back into American workers by educating them about the seriousness of the trade deficit and how it impacts them, their children and their future. Educate Americans on the importance of being competitive and of developing quality products and services to successfully compete in the world economy so that a sound and strong future for themselves and their children can be secured.

To ensure America's future by maintaining a growing economy that can employ our people, support our standard of living, and maintain our interests and prestige abroad, it is imperative that we provide capital, training, and education to our small businesses so that they can be competitive in the world economy.

Our economy is not self-contained anymore. The marketplace of America is the world. Our future lies in developing -- now -- the ability to compete there vigorously and effectively. Small businesses across the nation are asking you and the U.S. Congress to take the lead in supporting their efforts to make our country productive and competitive again!

TESTIMONY OF
VIRGINIA LITTLEJOHN
EXECUTIVE DIRECTOR
PROFESSIONAL SERVICES COUNCIL
BEFORE THE
SENATE SMALL BUSINESS COMMITTEE
FEBRUARY 25, 1987

Mr. Chairman and Members of the Committee:

I am pleased to have this opportunity to appear before the Senate Small Business Committee in the historic 100th Congress to discuss select entrepreneurial issues, particularly those affecting professional and technical services firms.

I appear in my capacity as Executive Director of the Professional Services Council. My focus today is on how effective utilization of America's new professional and technical services sector can help this country regain its competitive edge--in our ailing smokestacks, in space and other government programs, in sports. I will cite one recent example which illustrates how the process can work, and should work more often.

In 1983, for the first time in history, the United States lost the America's Cup---the crown jewel of sailing, which had resided in the United States for 132 years.

The Office of Naval Analysis, part of the Department of Defense's Office of Naval Research, asked naval architects at SAIC's marine hydrodynamics division in Annapolis why Skipper Dennis Conner's Liberty lost to Australia II. The answer was Liberty's outdated design, and the revolutionary hull and keel concept of the Australia II.

Soon, SAIC's naval architects and engineers were introduced to Conner and the President of the Stars and Stripes syndicate, Malin Burnham. A remarkable partnership ensued between the tigers of sailboat racing and one of California's most aggressively entrepreneurial, high-tech services companies.

SAIC viewed the race as more than a famous, 12-meter regatta. To them, it also raised the challenging question, "Is America competitive, or not?"

The company's engineers, analysts and computers went into overdrive, performing hull and keel hydrodynamic computer modeling, velocity predictions, wave resistance design work, and extensive statistical analysis of Australian wind and wave conditions under various conditions.

The design and technology team recast the keel in December, only weeks before the semifinals. The new keel, which had larger and heavier winglets, and was better aligned, added five seconds a mile in speed.

The result is history. Exactly as SAIC's computers predicted, the Stars and Stripes decisively won all four meets against the Kookaburra---winning back not only the America's Cup, but dramatically demonstrating America's technical prowess as well.

While the contributions of our member firms don't always make international headlines, SAIC's role in helping win back the America's Cup accurately showcases the capabilities of the professional and technical service industry: an industry which fields multi-disciplinary teams to provide innovative solutions to problems, in the process enhancing productivity and fostering competitiveness.

The Professional Services Council, whose membership includes six trade associations and about 75 individual firms, speaks for a relatively new and rapidly growing sector which is becoming an increasingly significant part of America's services economy. The industry's products are ideas and solutions---primarily the application of expert professional, technical, and specialized problem-solving knowledge to help government and private sector clients, both domestically and internationally, in addressing operational, technical and management issues and requirements.

Today, the industry encompasses research and development firms, computer software development houses, independent laboratories and test facilities, architect and engineering firms, systems integration and support companies, public accounting firms, and program analysis and evaluation organizations, to name a few. Our people are engineers, mathematicians, physicists, statisticians, accountants, program analysts, artificial intelligence specialists, computer scientists and programmers, social scientists, and specialists from many other disciplines.

Despite the significant contributions of professional and technical services firms to innovation, productivity and competitiveness, it is our strong impression that federal policy is lagging far behind the needs of America's new services and information economy, and posing barriers to its health and growth. This occurs both through sins of omission and sins of commission. Let me try to illustrate.

Improved Data and Statistics Reflecting the New American Economy

Since the end of the Second World War, our economy has undergone major transformations, from being primarily a manufacturing economy to a services and information economy. These rapid changes require effective management, but it is impossible to manage anything effectively if we do not understand its dimensions.

While the federal government produces bales of statistics, comparatively little useful information is available on economic growth, innovation, trade and productivity in emerging sectors of the economy such as the services, information and high technology sectors. Lack of sound data is a practical barrier to understanding the nature, dimensions and character of the new American economy and its dynamic entrepreneurial sector.

As management guru Peter Drucker bluntly puts it, "The aggregates on which all statistics are built are now 50 years old. And so the great national economic aggregates have been reliable plus or minus 40 percent--If you get that much slippage and still base policy on it, your chances of doing the wrong thing are simply too great."

Policymakers trying to formulate appropriate tax, trade and procurement policies are not the only ones who need realistic information to do their jobs effectively. In addition, America's private sector, struggling to meet the challenges of a new global economy, clearly needs realtime information to better understand the changing marketplace, to identify emerging market niches, and to prepare realistic business forecasts and projections which will enable them to compete.

Accordingly, we urge a wholesale overhaul of the anachronistic Standard Industrial Classification (SIC) codes, per recommendation #25 at the White House Conference on Small Business. Despite the allegedly "major" fifteen year-revision which has just gone into effect, these codes continue to provide at best only a rearview-mirror impression of the American economy--instead of a roadmap to guide us into the future.

Sesquidecennial revision of these quaint codes from yesteryear will not keep America competitive with the Pacific Rim!

As Casey Stengel so aptly put it, albeit in a slightly different context, "If you don't know where you're going, you might end up someplace else."

Unfair Competition from Federally Funded Research and Development Centers (FFRDCs)

Another important issue at the White House Conference was unfair competition from not-for-profits. While this is of generic concern to PSC members, our greatest concern is with Federally Funded Research and Development Centers (FFRDCs), which were referenced in both the #3 and #48 recommendations.

The increasingly labyrinthine nature of the procurement process has forced more and more technical and professional services work to be contracted to nonprofits which are captive to the federal government. Currently, they receive more than \$5 billion of professional and technical services work on a sole-source basis each year. This trend circumvents competitive procedures for the procurement of professional and technical services and directly hurts small and growing businesses which should be encouraged to do business with the federal government.

Since the passage of the Competition in Contracting Act (CICA) in 1984, the Department of Defense has announced the establishment of three Federally Funded Research and Development Centers---the Software Engineering Institute, the Logistics Management Institute, and the Strategic Defense Initiative Institute. In addition, the Nuclear Regulatory Commission has announced the proposed establishment of the Center for Nuclear Waste Regulatory Analyses, and other FFRDCs are under consideration by other agencies.

We believe that it is essential that the Senate Small Business Committee hold oversight hearings to determine how recent procurement initiatives, designed to help small and growing businesses, may unintentionally be having exactly the opposite effect. We are developing a set of specific recommendations urging that nonprofits captive to the federal

government be limited to only those missions that cannot otherwise be undertaken by highly capable private sector organizations.

Additionally, Congress needs to consider ways in which nonprofit institutes which are not captive to the government, provide commercial services without paying taxes, and unfairly compete with the private professional services sector.

Catalyzing Innovation, Productivity and Competitiveness through Procurement

Those of us in the private sector familiar with the procurement process consider it seriously flawed, and an example of federal regulation at its worst. The procurement laws, rules and policies, as presently framed and implemented, produce major inefficiencies and dislocations. This is particularly unfortunate because effective utilization of federal procurement—a \$200 billion annual market for goods and services—is one of the most direct ways in which government can stimulate innovation, productivity and competitiveness in the American economy.

Acquisitions by NASA and the Defense Advanced Research Projects Agency (DARPA), for example, have helped create extraordinary growth in post-World War II industries such as semiconductors, computers, and sophisticated new services which operate in a synergistic relationship with new technologies.

To catalyze innovation, productivity and competitiveness, steps must be taken to streamline and simplify procurement, while at the same time opening up access to small and growing firms. To assist in that process, we urge that prime contractors receive incentives for increasing their use of small businesses, as well as for providing management and technical assistance that will help these smaller businesses grow.

Rather than using regulatory methods which provide disincentives for growth, we believe that federal policies should encourage growth and job creation.

PSC is well along in formulating an innovative package of proposals that will foster small business access to the procurement system, and nurture growth and competitiveness.

Increased Competitiveness through an Emphasis on Quality

Federal procurement policies, which were designed primarily to procure widgets at the lowest possible cost, must be overhauled so that contracting officers can effectively acquire sophisticated professional and technical services in cases where quality should be a more important consideration than lowest cost.

While there has been intermittent attention given to quality in recent legislation and executive branch initiatives (the Competition in Contracting Act in 1984, the Office of Federal Procurement Policy's Study of Professional Services Contracting in 1985, the Packard Commission on Defense Management's 1986 report with language concerning professional services and R&D, and language emphasizing quality in the acquisition of professional and technical services and R&D procurement in the FY 1987 DoD Authorization Act), technical and qualitative capabilities still are not given proper weight in the acquisition of sophisticated services within the current statutory and regulatory framework.

Program managers and procurement officials face overwhelming political and bureaucratic pressures to emphasize cost considerations in their decisions, all too often compromising the quality of services in the process.

To improve the acquisition of sophisticated services, for starters, Congress must insist on methodologies that encourage, and even require, quality in buying technical skills. Every sophisticated procurement should produce a potential America's Cup victory.

As your colleague Senator Glenn wryly recalled from his days as an astronaut, he was acutely cognizant of the fact that his continued existence was dependent on equipment and systems that had been purchased on the basis of the lowest bid.

The Appropriate Role of Profit in Stimulating Entrepreneurship, Innovation and Competitiveness

One of the most serious threats now facing the industry concerns the Department of Defense's proposed new profit policy, which was developed in response to a directive in the FY 1987 DoD Appropriations/Continuing Resolution to reduce the profits of defense contractors by 1%, and to encourage capital investment.

Congressional language in the Conference Report recognized that professional and technical services firms may inherently be required to make less capital investment and to participate in projects with less total risk, but stated that "any profit policy must ensure that (professional and technical services) firms performing satisfactorily for the Department of Defense earn a reasonable profit."

The interpretation of congressional intent by DoD rulemakers is potentially devastating, however.

Currently, DoD profits for manufacturers average 12 percent, a figure which would be reduced to 11 percent under the proposed new profit rule. But, as interpreted by DoD rulemakers, the innovative professional and technical services and R&D sectors are expected to sustain a disproportionate reduction in profits because of the added emphasis on encouraging capital investments. Rather than investing in capital equipment, our sector invests in intellectual capital.

Preliminary analysis done by PSC companies in the last several months indicated there would be a reduction in profits of 25 to 50 percent---from a typical 8.75 percent profit now, to 4 or 5 percent under the proposed rule.

In the last three weeks, however, the Department of Defense has offered contracts to PSC member firms for professional and technical services and R&D work with profits of between 2 and 3.75 percent.

In response to recent questions raised by PSC CEOs in meetings with policymakers, DoD officials have stated their belief that "services firms don't need profits because they don't have any risk." These and similar views have left our members deeply concerned about the lack of understanding about how firms acquire and build capabilities in the private services sector to meet national needs.

Our most innovative firms, smaller entrepreneurial businesses, are dramatically hurt by this policy. Without profit, growing companies' access to working capital will be sharply reduced, thereby aggravating an already alarming problem. What is most painful is that the government, with the ability to fashion constructive policies to build our defense mobilization base and to nurture innovation and competitiveness, has chosen to take a very limited congressional mandate and to build a destructive monster.

Because a final profit policy rule is expected in April 1987, we have embarked on a major campaign in the next several weeks to educate DoD policymakers on the nature and contributions of innovative, highly technical services firms.

We ask members of this committee—who understand entrepreneurship and the vital role of profits in stimulating innovation, productivity and competitiveness better than anyone else in Congress—to aid us in educating DoD in Economics 101.

To assist you in understanding this issue, we have appended a detailed comment on profit policy which we filed with DoD on December 31, 1986.

A Final Recommendation Concerning America's New Services, Information and Technology-based Economy

In order to assist in formulating a range of legislative and regulatory policies that will build on the accomplishments of the new services, information and technology-based sectors of the economy, we urge the creation of the special commission referenced in recommendation #25 at the White House Conference. The commission's mission would be to analyze and propose policies which accurately reflect the new American economy, and which encourage productivity and competitiveness through emphasizing quality, innovation and service.

Conclusion

Washington's biggest buzzword in years, "competitiveness," means markedly different things to different people. How we ultimately define it will be a test of our vision, our leadership, and our national resolve.

This committee provides a unique forum to help define the term, sharpen the debate, and force the pace. Go to it with a vengeance, because our economic future depends on it!

Thank you.



PROFESSIONAL SERVICES COUNCIL

Representing companies
that are creating the
future through innovation,
technology and ideas

John M. Toups
President

December 30, 1986

Virginia Littlejohn
Executive Director

Lieutenant Colonel Richard J. Wall, USAF
Chairman, Joint Implementation Committee
ODASD(P)/PCPF
Room 3C800, Pentagon
Washington, D.C. 20301-3062

Subject: DoD Profit Policy - Interim Rule

Dear Colonel Wall:

On behalf of the members of the Professional Services Council (PSC), I would like to take this opportunity to comment on the DoD profit policy - Interim Rule on negotiated defense contracts published in the Federal Register on December 1, 1986 and effective October 18, 1986.

PSC represents companies and trade associations in the rapidly growing professional and technical services industry. PSC members include research and development firms, independent laboratories and test facilities, architect and engineering firms, systems integration and support activities, program analysis and evaluation companies, computer software development companies, engineering houses, and public accounting firms, to name a few. Their personnel include engineers, mathematicians, chemists, physicists, statisticians, computer scientists and programmers, artificial intelligence specialists, lawyers, accountants, program analysts, operations research experts, and specialists from numerous other disciplines.

Notwithstanding the changes incorporated in the Interim Rule as a result of industry comments made to the Proposed Rule published in the Federal Register on September 18, 1986, the Interim Rule, as currently drafted, will have a significant adverse impact on professional and technical services firms. A preliminary analysis of PSC member firms indicates the Interim Rule would reduce the profit objectives for such firms by 25 to 40%, making it increasingly difficult for R&D and professional and technical services firms to attract high quality personnel, and making it more difficult for these firms to provide the quality and innovative services the Department of Defense needs in order to effectively provide a strong national defense.

The attached document identifies specifically the nature and extent of the discriminatory nature of the policy as it pertains to our industry. In addition, recommended changes to the language of various sections of the policy are provided to eliminate what we believe is an unfair discrimination in the determination of profits for capital-intensive versus non-capital-intensive industries.

Members of the Professional Services Council would be pleased to meet with you at your earliest convenience to discuss positions reflected in the attached document.

Sincerely,

Virginia Littlejohn
Executive Director

Attachment

VL:ss

**PROFESSIONAL SERVICES COUNCIL COMMENTS
ON THE
INTERIM RULE ON PROFIT POLICY
FOR
DEPARTMENT OF DEFENSE CONTRACTS**

EXECUTIVE SUMMARY
INTERIM RULE ON PROFIT POLICY FOR DEPARTMENT OF DEFENSE CONTRACTS

The interim profit policy for defense contracts will have a significantly adverse affect on the profitability and economic viability of R&D and professional and technical services firms. It will reduce the profit objectives for such firms by 25 to 40%. An analysis of the revised weighted guidelines method for determining profit objectives for defense contracts awarded to professional and technical services firms shows that contracts which formerly yielded 7 to 8% will now yield 4 to 5% under the new policy. This prospective 3% reduction in contract profits will make it increasingly difficult for R&D and professional and technical services firms to provide the quality and innovative services the Department of Defense (DOD) requires.

The proposed changes in profit policy and their impact on the contract profits of R&D and professional and technical services firms exceed the congressional mandate for a one percentage point reduction in defense contract profits and conflict with the intent of Congress as stated in the Conference Report on the Department of Defense Appropriations Act, 1987:

"...the conferees recognize that some types of firms, such as professional and technical services firms, doing business with DOD inherently are called upon to make less capital investment and may participate in projects with less total risk. It is the conferees' belief, that, notwithstanding this modified emphasis, any profit policy must ensure that firms performing satisfactorily for the Department of Defense earn a reasonable profit."

The interim policy is also a major departure from previously established DOD profit policy which recognized that profit objectives for R&D and professional and technical services firms should be calculated on a basis different from those for capital-intensive equipment manufacturers.

To determine profit objectives for R&D and professional and technical services firms on the same basis as equipment manufacturers leads to discriminatory treatment of the R&D and services firms. For example, under the proposed policy, the return to a manufacturing firm would be significantly influenced by virtue of its fixed assets, i.e., plant, machinery, equipment and inventory. The same policy, when applied to a R&D or professional and technical services firm, ignores the fact that the principal assets of these firms are its people and the skills, innovativeness, and brainpower they possess. It is a changing asset and, in many cases, in short supply in the high technology area. To establish a process for determining profit objectives that is based primarily on physical assets while ignoring the value to the government of intellectual assets is a grievous mistake. The human assets of the R&D and professional and technical services firms providing services to DOD are as critical and important to the defense industrial base of the country as are the physical assets of equipment manufacturers.

A recent representative survey of professional and technical services firms indicates that the interim profit policy will have a serious negative impact on the economic viability of such companies. The combination of the decrease in contract profits, as a result of the new profit policy, coupled with a greater need for cash due to the increase in the types of unallowable costs, slower government payments, and the growth in withholdings resulting from delayed government auditing will place a financial hardship on professional and technical services firms. This will jeopardize their ability to maintain their economic viability, provide a reasonable return to their stockholders, and obtain necessary working capital financing. Small businesses, which are present in large numbers in the R&D and professional and technical services industry and which are seeking to grow by expanding their services to DOD, will be hit by this policy.

To assure that R&D and professional and technical services firms can continue to provide the quality services required by DOD, a set of specific changes to the interim profit policy are proposed. The proposed changes will alleviate the discriminatory treatment of R&D and professional and technical services firms and will enable those firms to attract and retain the highly skilled, expert personnel who are the major assets needed to provide the highly technical services that DOD requires for the development, production, maintenance, and support of its weapons and other defense systems. Most importantly, the recommended changes to the interim profit policy will avoid the severe reduction in normal profit objectives which would result from the interim policy and will provide as Congress intended "a reasonable profit." The following are the proposed changes:

- 1) Statement of the Intent of the Policy: new language to clarify for government personnel the purpose of the policy.
- 2) "Adjustment for Low Facilities Capital": language to amend paragraph 215.970-1 (a)(4) to recognize more equitably that R&D and professional and technical services firms' principal investments and assets are their personnel and not facilities and equipment.
- 3) Contract Type Risk Relative to Time and Material, Labor Hour, Fixed Price Level of Effort and Cost Plus Fixed Fee Contracts: language amending paragraphs 215.970-1 (b)(4), (5), and (6) to recognize the real risks for R&D and professional and technical services firms that are associated with these types of contracts.
- 4) Working Capital Adjustment Factor: language to amend paragraph 215.970-1 (c) to more adequately recognize the realities associated with contract financing.
- 5) Exclusion of G&A, and IR&D/B&P Costs in Profit Calculations: a proposal is advanced to continue the current policy of including these costs in profit calculations.

The interim profit policy fails to adequately recognize and give proper consideration to the basic fact that R&D and professional and technical

services firms have their heaviest investment in their highly trained, uniquely skilled personnel and not in plant and equipment. This fact was specifically recognized by past DOD profit policy. The new policy will create a situation where R&D and professional and technical services firms will find it difficult to attract and keep these personnel in order to provide the R&D and professional and technical services required by DOD. This could precipitate an undesired erosion of the defense industrial base as companies gradually refocus these resources toward markets which better recognize the value of intellectual assets. It is essential that the interim profit policy assure that actions being proposed primarily with the manufacturing sector of the defense industrial base in mind do not adversely affect the R&D and professional and technical services sector. The recommended modifications presented in the attached position paper would achieve this objective and should be incorporated into DOD's final profit policy.



STATEMENT
on
LEGISLATIVE PRIORITIES
before the
COMMITTEE ON SMALL BUSINESS
of the
UNITED STATES SENATE
by
Robert Millikin
February 25, 1987

Good morning. I am Bob Millikin, executive director of the Columbus Countywide Development Corporation, and Vice President for Congressional Issues of the National Association of Development Companies, representing certified development companies that lend money to small businesses under the SBA 503/504 loan program. I want to thank you for the opportunity to appear before this Committee today to discuss NADCO's legislative priorities for the 100th Congress.

We have identified five issues of particular concern that we would like to see addressed by this Committee.

1) Our first priority is assuring that a technical point in the FY 1987 appropriation for the development company program does not inadvertently prevent the use of \$155 million of the program's \$373 million allocation. That \$155 million, technically allocated to the 503 program for sale to FFB instead of to the 504 program for sale to private investors at a considerable savings to the federal government, may be lost without congressional intervention. If approvals under 504 continue at the current rate, money for the program will be exhausted some time during the third quarter of this fiscal year.

2) Of course, projected funding levels for FY 1988 are a chief concern, as well as the threat of additional "user fees" such as those proposed in the Administration's FY 1988 budget.

3) Prepayment of 503 loans held by FFB is another priority for CDCs and especially for their borrowers. Under the terms of the 503

debenture which funds the small business loan, FFB imposes prepayment premiums of as much as 50 percent of the outstanding principal balance. Some of these loans carry interest rates as high as 15-1/2 percent. We would propose that Congress grant authority to refinance those loans, at substantially lower rates and at substantial savings to the federal government, through the privately-funded 504 process.

4) NADCO is also interested in participating in any discussion concerning the possible sale of 503 debentures currently held by FFB. If that portfolio were to be sold without recourse, we would recommend that CDCs be given the option to re-purchase their own debentures. This would protect the small business borrower from unusually harsh collection or liquidation procedures, and preserve the servicing system currently in place. If loans are to be sold with recourse, we would recommend coordination of those sales through the Development Company Funding Corporation, which acts as selling agent to CDCs in the 504 program. DCFC's coordination would assure an orderly marketing procedure that will not compete with 504 debenture sales and will benefit both asset sales and the 504 program.

5) Finally, we would like to initiate a discussion with the committee concerning raising the ceiling of \$500,000 per borrower for 504 loans.

BACKGROUND

The Small Business Administration's 503 lending program was established in 1980 by section 503 of the Small Business Investment Act to provide long-term, fixed-asset financing to qualified small businesses through local development companies certified by SBA. To qualify for assistance under the development company program, a small business must demonstrate that the financing will have a significant economic impact in its community, usually through job creation.

The program is designed to work in conjunction with private sources of financing. Typically, a commercial lender provides 50 percent of the project cost in return for a first position lien on the property or machinery being financed. The CDC debenture, fully guaranteed by SBA, provides 40 percent and is secured by a second lien position. The remaining 10 percent equity is provided by the small business borrower.

Since its inception, the 503 program has issued more than \$800 million in debentures, which in turn has leveraged well over \$1 billion in private capital to create more than 100,000 job opportunities throughout the country, at an average federal investment of \$7,400 per job.

PRIVATE SALE FUNDING

SBA 503 debentures approved prior to July 1, 1986 were funded through the Federal Financing Bank at an interest rate equal to the

comparable Treasury rate plus one-eighth of a point administrative fee. However, a change in this funding procedure was mandated by the Combined Omnibus Budget and Reconciliation Act of 1986, which was signed into law April 7, 1986.

The Act requires that debentures be sold to private investors rather than to FFB. This change was intended to preserve adequate funding levels for the program while significantly reducing the program's cost in terms of SBA budget authority. The result under current budget accounting is that privately sold development company loans are scored as guaranteed loans instead of direct loans in the SBA budget.

In designing the system for private sale of debentures, every attempt has been made to make the transition as orderly as possible. With few exceptions, credit and other requirements and procedures for borrowers, CDCs and SBA have been preserved. SBA's considerable efforts to comply with very strict deadlines for implementation mandated by the law made the transition to the private market possible without a break in CDCs' ability to offer lending assistance to qualified small businesses. We are extremely appreciative of their work.

On July 1, 1986 the SBA began guaranteeing development company debentures for funding in the private capital market. These debentures are known as "504 debentures" to distinguish them from "503 debentures," which are sold to FFB. SBA-guaranteed 504 debentures are sold through the Development Company Funding Corporation (SBA-appointed Selling Agent for CDCs) to underwriters, who pool them and offer certificates representing interests in the pool to investors.

The first sale of 504 debentures took place in November, 1986. Sales of 20-year debentures have continued monthly since then and 10-year debentures, which have a lower volume, are being sold quarterly.

The debentures currently carry a fixed interest rate of approximately 115 basis points higher than Treasury yields over securities of comparable maturities. Since the debentures are amortized with periodic payments of principle and interest in much the same manner as a home mortgage, they are estimated to have an average life of about one-half of their stated maturity. Therefore, we use the Treasury 5-year and 10-year rates as a basis for determining the 10-year and 20-year debenture rates, respectively.

For example, 20-year debentures sold in February 1987 carry an interest rate of 8.40 percent; 115 basis points above the 7.25 percent 10-year Treasury rate. The effective rate to the borrower after servicing fees are added is approximately 9.0 percent.

Additional frontend fees to the borrower associated with private sale of 504 debentures are as follows: a fee to the underwriters of approximately 5/8 of one percent and a funding fee of 3/8 of one percent to cover printing, legal and DCFC expenses. The two percent reserve account in the 503 program (which belonged to the borrower) has been replaced with a non-refundable 1/2 percent fee paid to SBA. Servicing fees to the CDC (1-1/2 percent) and the Central Servicing

Agent (1/4 percent) remain unchanged from the 503 program. Total front-end fees in the sale of a 504 debenture add up to 3-1/4 points.

More than \$200 million in small business assistance has been approved by SBA through this private-sale program since it began last July. Of those approvals, more than \$40 million has actually been funded.

I. FY1987 BUDGET AUTHORITY

Congress initially authorized the private sale of development company debentures on a pilot program basis. In FY1986, \$200 million of the \$387 million development company program appropriation was targeted for sale to FFB, with the balance for private sale to investors. This allowed SBA and the development company industry time in that fiscal year to use FFB authority, while developing and implementing a process for the private sale.

As a precaution in that FY1986 budget, Congress allocated \$155 million of the FY1987 program authority for sale to FFB. If the private-sale program were not a success, there would at least be some money for the program available in the next fiscal year. If the pilot program were successful, Congress would have the opportunity to move the entire FY1987 authority into the private-sale program as part of the FY1987 budget process. In fact, language to do so was to be included in the FY1987 budget conference report. However, issues unrelated to this program prevented the House and Senate from issuing a conference report on the SBA budget, so the adjustment was never made.

Initially, using that authority to tap back into the substantially lower rates available through the 503/FFB program seems very attractive. However, after careful consideration, we believe that such a move would not be in the long-term best interests of the program. This Committee has indicated that it intends to make permanent the pilot program of private sale. NADCO concurs with this decision. The budgetary impact of a 503 program that is scored dollar-for-dollar would preclude Congress from appropriating sufficient levels of authority to meet the program's demand. The switch to private sales solves that problem.

Given that fact, however, attempting to revert to 503 program procedures to use the \$155 million would be an administrative nightmare. More importantly, it would be very destructive to the ongoing 504 program. An interruption of the flow of debentures into the market would raise questions in the minds of investors which would likely translate into higher interest rates for future 504 borrowers. It would also create the inequitable situation in which borrowers receiving 503 loans would have the benefit of interest rates more than a full percent lower than other, similarly qualified borrowers receiving 504 loans.

Finally, transferring authority from FFB to the private sale program would save the federal government a considerable amount of budget expenditure. Loans sold to private investors only cost the government in the event of default. Loans sold to FFB are dollar-for-dollar outlays that must be included in SBA's budget.

At the current rate of activity, private-sale authority will be depleted some time in the third quarter of this fiscal year. We request that the Committee take action before that time to assure that small business borrowers will have access to the full amount of assistance Congress intended through the development company program.

II. FY 1988 SBA BUDGET

We ask that the Committee maintain a funding level for the development company loan program of at least \$373 million in FY 1988 to ensure that funds are available to meet the small business demand for these loans. Current authority is running just about at the level of demand. In fact, demand outstripped authority at the end of the first quarter of this year, causing some borrowers to have to wait until second quarter money was available to get approval for their loans. Further, as tax-exempt bonds and other traditional means of economic development financing become more scarce, we believe demand for this program will increase. Its track record and low default rate (under three percent) make it an effective use of limited government funds.

One aspect of the Administration's budget that especially concerns us is the proposed imposition of additional fees on most SBA guaranteed lending programs. We believe that fees are already pushing the limit of what borrowers can afford when trying to secure financing, and would oppose such increases across the board.

This is particularly a problem in the 504 program, however, due to the significant increase in fees and in interest rate this program has absorbed as a result of leaving FFB. The cost to borrowers of this change is well over one percent added into the interest rate of their loans. Also, an additional point up front has been added to cover the administrative costs of selling debentures in the private market, as well as a new, one-half percent fee charged by SBA. A total of 3-1/4 points up front is currently charged to a borrower for his or her 504 financing.

One other point we would like the Committee to consider in this regard is the benefit accruing to the SBA in interest income under this program. The debentures that CDCs sell to fund 504 small business loans amortize semiannually, while the corresponding notes paid by the borrowers amortize monthly. The borrowers' monthly payments are sent to a master account owned by SBA and maintained by the central servicing agent for the program. When a semiannual payment on the debenture is due, the payment is taken from that master account out of the monthly payments made by the borrower. However, the interest earned on those monthly payments remains in the account and belongs to SBA. Interest on a separate fee account similarly owned by the SBA and maintained by the central servicing agent also accrues to SBA's benefit. We do not have exact dollar amounts to present to you today, but we are working on projecting the benefit to the agency, and translating that dollar benefit into an up-front fee equivalency. We will make this information

available to the Committee, and hope that you will take this very real contribution by the borrowers to the SBA into account when considering the issue of additional fees.

III. PREPAYMENT OF 503 LOANS

We are extremely concerned about the adverse impact on small business borrowers of current prepayment terms on SBA 503 debentures held by the FFB. These terms, established by FFB and imposed even on SBA if it must purchase a debenture in the event of default, provide for a premium or discount based on the relationship between interest rates when the loan was made and current rates at the time of prepayment. I will not begin to try to explain FFB's rationale for imposing these terms, or its formula for calculating the prepayment price, but I can tell you that the bottom line to the borrower can be more than 50 percent of the outstanding principal balance owed. What's more, FFB charges the borrower a \$1,000, non-refundable deposit just to determine what it will cost to prepay.

These severe premiums are the result of a significant drop in interest rates over the past five years. Borrowers obtaining financing in 1981, for example, may be holding loans with interest rates of as much as 15-1/2 percent. That was an attractive rate when prime was over 20 percent, but many borrowers are understandably upset at the prospect of being tied to this high rate when loans are currently being financed at something closer to nine percent interest.

I might add here that this is only a problem in 503 loans sold to FFB, not in loans sold to investors under the 504 program. Because of our concern about the adverse effect of the 503 prepayment terms, the industry worked with SBA to design more reasonable and manageable prepayment terms for 504 borrowers. The 504 borrower is given a schedule at the time the loan is made detailing an exact dollar amount of prepayment premium, which declines ratably over the first half of the term of the loan. 504 borrowers may prepay at par at any time during the second half of the term of their loan.

Senator Metzenbaum (D-OH) attempts to address the 503 prepayment problem in a bill he introduced on February 3, 1987 which has been referred to this Committee. This legislation, S. 437, would preclude the FFB from imposing a premium on borrowers who wish to prepay their 503 loans. NADCO supports the concept of allowing 503 borrowers to prepay their existing loans with the FFB at par, and commends Sen. Metzenbaum for his efforts in championing 503 borrowers. However, we believe that this bill does not go far enough, and that implementation in its current form would continue to disenfranchise those borrowers most in need of relief. Sen. Metzenbaum's approach is only a solution to inordinately high interest rates for borrowers who are capable of obtaining conventional financing. The whole point of this guarantee program is to allow small businesses who cannot get conventional financing to expand, create jobs, and spur economic

development in their communities. Only the most healthy (and least in need of a break from the federal government) will benefit from this legislation as it now stands, because only they will be able to replace their 503 loans with conventional loans at lower rates.

We would recommend that Congress go one step further to better serve the needs of those it intended to assist in the first place. By allowing 503 borrowers to refinance their loans through the 504 private sale process at substantially lower rates, Congress would indeed assist those borrowers. At the same time, it would reduce the federal government's contingent liability and have the effect of selling that 503 asset at par, presumably resulting in a budgetary savings. No new budget authority should be required, because the agency's liability has not changed as a result of the refinancing. Obviously, details of such a plan would have to be carefully worked out, but we believe it is workable, and would benefit the borrowers and the federal government. If this concept interests the Committee, we would welcome the opportunity to explore the matter further.

IV. SALE OF 503 ASSETS

Should the Committee choose not to pursue the possibility of refinancing the 503 portfolio, that portfolio may well be a candidate for a more traditional asset sale. NADCO is interested in participating in any discussion concerning the possible sale of 503 assets. In terms of logistics, some immediate questions come to mind:

- o Would the sale be the responsibility of SBA or the FFB?
- o If the SBA were to conduct the sale, how would the portfolio be transferred from FFB, and would that transfer require an appropriation?
- o If an appropriation were needed, would it be for the outstanding principle balance of the loans being purchased, or for the prepayment price as calculated by FFB?
- o How would such a sale be scored under each of the scenarios described above?

Obviously, these questions cannot be fully answered until a determination is made about whether to sell with or without the federal guarantee. If that portfolio were to be sold without recourse, we would propose that CDCs be given first option to purchase their portfolios. This would protect the small business borrower from unusually harsh collection or liquidation procedures that might be taken by a private investor without any personal interest in the borrowers and over whom SBA has no regulatory authority.

If Congress pursues a sale with recourse, we recommend that the procedures for selling 504 debentures already in place be utilized in selling 503 debentures. A marketing and underwriting process has

already been established consisting of parties who are familiar with the program and the security. Also, by conducting the sale through the Development Company Funding Corporation (selling agent for CDCs in the 504 program), timing of the 503 asset sales can be coordinated to assure they do not compete with the ongoing monthly sales of 504 debentures and that the best price is achieved for the asset sales.

V. CEILING ON 504 ASSISTANCE TO A BORROWER

Currently, there is a \$500,000 ceiling on the amount of SBA-guaranteed financing available to any single borrower under the 504 program. NADCO recommends increasing that ceiling to \$1 million per borrower. We make this request for the following reasons:

- o Market pressures, brought on at least in part by the declining availability of IDBs and IRBs has increased the demand for long-term financing -- which is the main thrust of small business expansion -- of projects in the \$1.5 - \$2.5 million range. We currently are unable to make a significant contribution to projects of this size. Our normal participation of 40 percent of total project costs would be \$600,000 to \$1 million for these size deals.

- o The natural impact of inflation since the program's inception in 1980 has had the effect of limiting our ability to assist legitimate economic development projects of firms that fall well within the SBA's requirements to be considered a "small business."

- o Because the program has a requirement that one job be created per every \$15,000 of 504 debenture, an increase in the ceiling would not compromise the job creation and community impact aspect of the program. In fact, the job-creation impact is often much greater for slightly larger projects.

VII. CONCLUSION

The issues outlined above have been identified by NADCO's Board of Directors and members as priorities for the current legislative session. We appreciate the opportunity to appear before you today, and look forward to working with the Committee in the coming months on these various issues.

Mr. Chairman, this concludes my prepared remarks. I would be happy to answer any questions you and the other Members of the Committee might have.



National Association of Plumbing-Heating-Cooling Contractors

Pride In Our Past—Faith In Our Future

STATEMENT
TO THE
COMMITTEE ON SMALL BUSINESS
UNITED STATES SENATE

Presented by:

Gary Nave, NAPHCC Legislative Committee
Nor-Well Company, Elizabethton, Tennessee

on behalf of the
National Association of Plumbing-Heating-Cooling Contractors

February 25, 1987

- 1 -

Mr. Chairman,

Mr. Chairman, my name is Gary Nave and I am Vice-President of Nor-Well Company, a 27 year old contracting firm in Elizabethton, Tennessee. Nor-Well is an open shop company that does approximately \$4 million in volume and employs 60 people. We do commercial and industrial contracting, plumbing, heating, air conditioning, sheet metal and fire sprinkler jobs.

As a member of the Legislative Committee, I am here today representing the National Association of Plumbing-Heating-Cooling Contractors (NAPHCC). Accompanying me is the NAPHCC Director of Government Affairs Dennis Lavallee. In addition to my role in the NAPHCC, I am also a past president and current Board member of the Tennessee State PHCC and have held every office in my local PHCC association.

The National Association of Plumbing-Heating-Cooling Contractors is the oldest national association in the construction industry and the largest plumbing and mechanical subcontractor association. We have more than 6,000 members. Membership comes from every state in the country and is organized through about 300 state and local affiliated associations. This industry employs over 510,000 people and has receipts of 32 billion dollars.

We are here today to highlight our legislative priorities for the 100th Congress and to ask that you include these as you set the Senate Small Business Committee's Agenda and work plan.

We greatly appreciate the leadership which this committee has provided to promoting the best interests of small business. We hope that leadership will continue.

DOUBLE-BREASTING LEGISLATION

Companion bills have been introduced in both the Senate and in the House which would severely curtail competitiveness and flexibility in the construction industry. Commonly known as the dual shop or the double

breasting legislation, they are S.492 and H.R. 281. The bills would limit the freedom of investment and ownership, destroying the right to choose business opportunities. Since a large number of construction firms are small business, this would have a disproportionate adverse impact on small business and their employees. Regretably, two of the sponsors are also members of this committee.

Under existing law, owners of construction firms are permitted to own and operate separate and distinct construction companies with different labor relations policies. Thus, I could own an open shop company that employs non-union people and a union company that employs union members, subject to the collective bargaining agreement. This dual shop arrangement is legal only if day to day operations, general management, and labor-management relations are kept separate. If I do not properly establish and maintain these separate identities, the law requires that the collective bargaining agreement of my union company would apply to my non-union company.

In the current construction market, some communities and some jobs will have work done only by union contractors. In other communities or on other jobs, bidders can only be successful if they bid non-union. On some jobs, the prime contractor may be a union contractor and subcontractors may be non-union. On still others, just the reverse may be true. Existing labor law permits this while providing a careful balance through the National Labor Relations Act (NLRA) against abuses.

In fact, from October 1983 through July 1986 there were over 100,000 unfair labor practice charges filed, according to the National Labor Relations Board (NLRB). Of those, only 107 (or one-tenth of one percent) dealt with the conduct which supporters of this legislation want to prevent. These statistics hardly support the contention that there is wide spread abuse.

The legislation would make a significant change in labor law by adding a new definition. It would add to the NLRA a definition for "single employer"

as any two or more companies doing "the same or similar work, in the same or different geographical areas" and "having directly or indirectly--substantial common ownership; common management; or common control."

Furthermore, the bills would give pre-hire agreements the full status of a collective bargaining agreement even though the employees have not agreed to such an agreement.

"Pre-hire agreements" are unique to the construction industry under the law. They permit contractors and unions to negotiate terms and conditions of employment before the first worker is hired. However, rather than permitting workers to opt into a union through the customary election process, the bill would force these new employees to accept a union and then attempt to opt out through a decertification process.

This clearly weakens our current labor laws which are intended to protect employees. It limits employee control over their own labor destinies by forcing employees to accept representation by a union even though a majority of employees may not want to be represented by that union or by any union.

As Secretary of Labor William Brock stated in his April 14, 1986, letter to the House of Representatives, "Our labor laws guarantee that the choice of whether to join a union is the employee's, not the employer's and not the union's." He urged the House to reject the bill.

In current public policy debate, a great deal of attention is devoted to competitiveness. While promoting competitiveness internationally, it would certainly be counter productive to limit competitiveness domestically, especially among small business. Yet, that is what these bills would clearly do. They would restrict free enterprise by preventing contractors from competing in both of the two sectors of the market, union and non-union. A contractor would be forced into being one or the other, thus reducing the number of competitors. Decreased competition in either sector will lead to

higher prices.

While last year's House debate on the legislation specifically disavows an intent to permit common sites picketing, the language in the bill does not permit us to feel secure. The restrictive nature of the legislation will force construction jobs to be completely union or completely non-union.

The impact on small business should not be overlooked. Since a great many construction firms are small businesses, this restriction on free enterprise will restructure the competitive marketplace and force many companies out of business. Perhaps that's why the 1986 White House Conference on Small Business included opposition to double breasting legislation among its top 60 recommendations. NAPHCC places opposition to this as our number one priority. We urge you to do so also.

FULL AND PROMPT PAY

We have continued to be concerned with the way in which the federal government pays its bills. Thus, we actively supported passage of the Prompt Pay Act of 1982.

While progress has been made on prompt payment policies, they stop short of providing the full measure of equal treatment that they should provide. This is particularly true for subcontractors and for federally-assisted jobs funded through grants, loans, mortgage insurance or other assistance. These jobs should rightfully be entitled to full and prompt payment of both progress payments and final payments.

Therefore, it is imperative that you expand the policy to insure that payments flow promptly through the system. That's why we supported Prompt Pay Improvements (S.2479) which passed the Senate last year. That's also why we appreciate the sponsorship by several members of the committee of similar legislation (S.328) this year. However, we hope some additional improvement can be made in the bill to correct critical payment problems.

There are many small businesses who provide the goods and services which enable prime contractors, grantees, loan recipients, etc., to fulfill their obligations with the federal government. Just as small business cash flow and economic survival can be critically injured by slow pay in direct relationships with the government, so also can they be hurt when they provide goods and service through intermediaries.

Slow pay can seriously undermine productivity and drive up costs to the taxpayer. A major problem in construction is proper scheduling. If materials are not on the job site, construction is delayed. Contractors delay ordering materials because of slow pay. When they do so, some materials may not be available. If materials aren't present, scheduling is delayed, workers are idle or laid off and productivity is lost.

However, there's one more reason why the government should require prompt payment. It's right.

The federal government has a responsibility to the taxpayers and to its contractors to see that its money is being used right. That includes seeing that the funds flow through to the subcontractors who do the work and that includes seeing that government supported activities are properly managed.

In surveys of members of NAPHCC who perform work for the federal government, it is not unusual to find payment delays in excess of the 30 to 45-day cycle which is customary in the construction industry (See Attachment-A).

Many of these payments passed through intermediaries. While this may contribute to some minimal delay, the record of longer delays indicates far more severe problems with payments which are being delayed in the payment process.

If it's a direct federal procurement, then the Prompt Pay Act applies and interest penalties are due. This interest should be passed on to the

subcontractor who did the work. If the prime contractor has delayed payment, he should be liable for interest. It is in the best interest of the federal government to have prime contractors pay their subcontractors promptly to avoid delays on the project and promote timely completion.

Frequently, delays in payment are reported on federally-assisted work performed through grants, loans, and mortgage guarantees. Similar to the benefits of flow through of payments from primes to subs, the federally-assisted route should also encourage quick payment to those who perform the work.

When contractors complete their work, or a portion of it, they certify its completion and request payment. While certainly inspection of the job may be necessary to assure that the certification is accurate, it should be done promptly. There should be no excuses for tying up payment in the bureaucracy.

Just as there were prior to enactment of the Prompt Pay Act, there will be cries that the process can't work that quickly and that interest penalties will hamper the work of those receiving federal assistance. However, with the force of the law requiring prompt payment or interest payments on late payments, federal agencies were able to comply far more effectively than their dire predictions. We believe that payments through federally-assisted programs can likewise be jarred to greater efficiency when there is a legal incentive.

As an example, NAPHCC members on federally-assisted jobs are told by federal agencies, such as HUD, that the agency has no control over the payment practices. Yet they admit that their regulations require withholding a 10 percent retainage from construction progress payments. Then they do little to help as contractors wait months and even years to receive their final payment (i.e. retainage) on HUD backed work.

HUD officials callously disregard our pleas for fairness and have

suggested to our members that we need not bid on work if we don't like the contract terms. Some of those same officials have even suggested that small business contractors could jointly agree not to bid jobs where payment terms are not acceptable. They completely overlook antitrust laws which prohibit such joint economic action.

It's a simple fact. Contracts financed with federal funds, such as HUD mortgage insurance, have late progress payments and final payment. This is a problem for small business construction contractors. It is further complicated because payment must first be made to the prime contractor who then uses the proceeds to pay subcontractors, and they in turn their second tier subcontractors, suppliers, etc.

Final payments on construction work are of special concern. Frequently, these are larger payments incorporating retainage that may have been withheld through the course of the job. It is not unusual for a contractor to have completed a job and see the project in use while the contractor continues to wait for final payment for months or even years after completion.

Final payments, including retainage, should be paid promptly and on a line-item basis to subcontractors upon substantial completion of each subcontractors work. Where sums have been retained for punch list items, the amount retained should be no more than the value of the punch list items and then released when the items have been completed. Furthermore, final cost certification should include all change orders and be confirmed by the contractor and the subcontractor.

If final payment is not immediately forthcoming to the contractor for work substantially completed, funds due to the contractor should be placed in an interest earning escrow account for the benefit of the contractor.

Federal policy requiring both prompt payment of progress payments and retainage as well as interest on late payments will encourage quick completion

and fair treatment to all participants in the project.

It is critical that Congress retain flow through of payments and interest to subcontractors. However, it is also critical that Congress extend prompt payment to federally-assisted work, such as HUD mortgage insurance.

UNFAIR UTILITY COMPETITION

The problem of unfair utility competition affects plumbing-heating-cooling contractors and a number of other industries which are primarily small businesses.

Small businesses support fair and open competition. However, a utility company is given protected status. The utility is granted monopoly status (free from competition) and is guaranteed the opportunity to make a profit. In exchange for this protected status, it is regulated by the state regulatory commission.

Usually a large business, its size and resources far outstrip many small businesses in the community. When this protected entity is permitted to compete in other markets, there are market advantages which it enjoys which are unmatched by most others, particularly small businesses.

What's the nature of the resources that provide a utility with that market advantage?

- 1) **Cross-subsidization** - While state regulatory commissions generally prohibit a utility from using its regulated activities to subsidize its unregulated activities, energy audits are one notable exception in which the utility is congressionally mandated to use ratepayer money to subsidize a business activity currently performed by small business. In addition, we believe that the commissions are not effectively controlling ratepayer subsidization of a utility's indirect costs.
- 2) **Capitalization** - The utility may provide loans, loan guarantees or other financial subsidies to a new business activity.

- 3) **Administration and overhead** - Management, planning, accounting, legal assistance, research and development resources may be used by a utility to start up or operate other lines of business. In addition, office space, equipment or personnel of the utility may be available.
- 4) **Name** - Instant name recognition is a valuable asset which a utility enjoys when venturing into a new market.
- 5) **Credit information** - From customers' bill payment records, the utility has a built in source of credit information for use in other business activities.
- 6) **Billing** - Postage, mailing and personnel costs are already being paid by the ratepayers. Adding charges for other business activity to the bill produces very little expense to the other activity.
- 7) **Advertising** - In many states, advertising costs can be passed on to ratepayers. While advertising directly connected with an unregulated activity may need to be charged to that activity, there are many opportunities for the utility to also include material with advertising promoting its regulated activities. The postage for bill stuffers promoting a service contract is paid by ratepayers as part of their utility bill.
- 8) **Direct mail** - With utility bills going out monthly and with immediate access to customers initiating or terminating service, utilities have the most up-to-date mailing lists in existence.
- 9) **Market data** - To promote their fuel type, utilities frequently have extensive market data on their customers. This may readily be made available for marketing of its unregulated business activities.
- 10) **Selective referral and market allocation** - With its access to information on consumer needs and requests, a utility can make or break a small business by arbitrarily referring or not referring business. That

same market advantage can be of tremendous competitive value if the utility funnels the business to itself.

- 11) Direct from the manufacturer ordering - With larger volume orders, the utility can circumvent usual distribution channels, such as suppliers, contractors and retailers, and buy direct from manufacturers with possible favorable pricing for bulk orders.
- 12) Consumer financing - The utility's large capital base gives utility access to providing favorable consumer financing. Financing may be added right on to the utility bill.
- 13) Consolidated financial statements and tax returns - The utility may reap financial benefits from consolidating its financial data for stock, bond or tax purposes. Furthermore, ratepayers may pay higher utility rates when weak financial statements caused by losses in unregulated activities force up bond prices.

These are some of the more significant benefits which a regulated utility monopoly will have which are not as readily available to unregulated small business. In fact, they may not be available at all.

Why isn't this a state issue rather than a federal issue?

It is, in fact, an issue in many states as small businesses initiate and intervene in state commission proceedings. However, unfair utility competition is also an issue for federal public policy concern:

- 1) When state commissions decline to consider the issue of competition or conclude that they do not have authority over the unregulated activities;
- 2) When utility practices violate the antitrust laws;
- 3) When Congress requires utility activity;
- 4) When utility activities cross state lines preventing effective regulation by a state commission.

How is the consumer affected? If utilities are permitted to control the market or limit competition, consumer choice is reduced. Yet the consumer has been required by the state regulatory commission to subsidize the indirect costs of the utility to conduct its unregulated activities which are now reducing consumer choice.

The consumer would be better served if the unregulated activities of a utility are expensed at full market based costs and credited to the utility function. If a bill stuffer goes with the utility bill, all of the costs for the bill stuffer, postage, and mailing should be charged to the unregulated activity. Such a proposal would lower rates since many of the indirect costs would no longer be charged to the ratepayer, but to the unregulated activity.

Thus far, our efforts to combat unfair competition by utilities have met with mixed results. We certainly appreciate the leadership this committee has provided in assisting with the problem. The Senate Small Business Committee conducted hearings on utility competition in November 1983, which were extremely useful in focusing attention on the problem and possible courses for remedy.

Those hearings, together with support from the Small Business Administration Office of Advocacy, have produced increased attention to the problem by the Congress, Federal Trade Commission, Department of Energy and state public service commissions. However, we need your continued diligence in pressing for more comprehensive solutions.

MANDATED BENEFITS

NAPHCC opposes efforts by government to mandate to employers the health or disability benefits to be offered to employees. These are unwarranted intrusions into the marketplace that will have particularly disruptive effects on small business.

As you are surely aware, federal and state governments require employers

to participate in unemployment insurance, workers' compensation and social security programs. Each provides benefits to current or former employees. They are paid for by employers based on wages paid to employees. Their cost can be readily included in the cost of doing business. Together, they provide a basic safety net of employee benefits. Many employers voluntarily provide additional benefits for vacation, health insurance, sick leave, etc. However, these are employee benefits which either are collectively bargained for or are offered by employers to be competitive in the labor market.

In recent years, there has been growing interest in Congress to mandate that employers offer additional specific benefits to present and former employees. In 1985, Congress required that employers permit former employees to continue participation in the employer's health plan at the former employee's own expense. Since then, proposals have been introduced to require employers to pick up that expense.

Other proposals have been introduced to require employers to grant extended leave for disability or parenting responsibilities. Initial proposals call for unpaid leave, but others have proposed that employees on leave be paid. These proposals undermine the free enterprise system. Since all employers will be offering similar benefits required by law, they will be less competitive in attracting new employees. Furthermore, the cost of these benefit programs will be more difficult to estimate and to include in business cost. Several key employees taking leave simultaneously or unexpected high turnover could quickly turn a successful small business into bankruptcy.

Although employment is a key element of many insurance programs, it does not mean that loss of a job means loss of health insurance. First, many employers provide extensive health coverage for their employees upon layoff. For most employers, the continued coverage ranges from one to three months which effectively provides protection for about two-thirds of the unemployed.

Second, most state insurance codes require employers to offer continued enrollment at employee expense to all employees who leave the job. Some employers not covered by state codes exercise this option.

Third, many of those becoming unemployed come from households in which some other family member is also a the source of group health insurance. Overall, two-thirds of those families with an unemployed family member have someone else in the family who is working.

Finally, the unemployed may purchase their own health insurance and may be eligible for either medicare or medicaid assistance.

There are particularly unique problems for the construction industry if a Federal program mandates that small business construction contractors pay for extended health coverage to the unemployed beyond what already exists. By nature, construction is a seasonal occupation and workers expect to be unemployed for stretches of time. The high wages in construction are partial compensation for periods of inactivity. Given the high turnover rate in construction, often exceeding 300 percent, the cost of providing health insurance to the revolving door employee could break many small business contractors and lead to even higher unemployment.

Furthermore, turnover in the construction industry raises questions of eligibility and duration of benefits. How long should an employee have to work before he could take advantage of extended health care benefits? Additionally, how long should the benefits last?

The enactment of new health legislation such as proposed would pose new problems for employers and private sector health plans. At a time when many collective bargaining health and welfare plans in the construction industry are already faced with economic difficulties (due to reduced contributions), the imposition of additional cost could be tragic.

We urge you to oppose legislation that could impose new requirements for

additional benefits. The small business person, who often treads a fine line of profitability, will be hard pressed to comply with new mandated benefits. A small business that is out of business will be unable to provide any additional benefits. Furthermore, the former employees of the out-of-business small business will lose the benefits they had.

Conclusion

In conclusion, I have attached association position papers for each of the issues I have discussed. NAPHCC strongly opposes double breasting legislation which restricts competitiveness in the construction industry. It limits the freedom of investment and ownership, and destroys the right to choose business opportunities. It also alters existing labor laws protecting workers' rights to choose whether to join a particular union or any union and weakens their right to control their own economic destiny. Small business construction contractors and our employees are severely impacted by proposed double breasting legislation.

The Prompt Payment Act was intended to assist small businesses in getting timely payment from the government so that they could maintain themselves as viable economic entities with the ability to compete in the marketplace. The complete beneficial effect cannot be felt until the same principles for fair treatment are extended to subcontractors and to projects supported by the federal government.

We are indeed pleased that the Congress is examining implementation of the Prompt Pay Act. The Senate legislation corrects several deficiencies, but should be expanded. S.328 is an important first step to fine tuning the spirit and intent of the Act by addressing continuing problems which small businesses face in getting paid promptly.

On unfair utility competition, we appreciate your efforts to focus attention on these problems. We hope that the committee can continue its

oversight function, particularly as the protections against unfair utility competition in the Conservation Service Reform Act of 1986 are implemented and as the attention of state utility commissions are directed to the problem.

Finally, we hope that you will help the Congress to avoid new mandated benefit programs. They will be of little value to employees when they force their small business employers out of business.

Thank you for providing this opportunity to share the views of the National Association of Plumbing-Heating-Cooling Contractors.

I would be happy to answer any questions.

DL/jat/3001G

ATTACHMENT A

SEVERE PAYMENT DELAYS ON HUD CONTRACTS

Following are results of a survey of members of the National Association of Plumbing-Heating-Cooling Contractors (NAPHCC) who do federal work for the Department of Housing and Urban Development. The survey was conducted during the summer of 1985.

Approximately 700 surveys were sent to the network of contractors who perform HUD work. Of those, 85 were returned indicating they no longer do HUD work.

There were 87 usable responses by contractors who continue to perform work for HUD either through direct contracts or subcontracts with HUD or through federally assisted jobs.

26	Do primarily service work and/or small contracts
41	Do large jobs
20	<u>Type of work not provided</u>
87	Total responses

Generally, those who do service work and small contracts are satisfied. There was almost never retainage held and payment averaged 31 to 45 days. Contractors were generally satisfied with their HUD office and personnel.

For contractors who perform large jobs, HUD treatment was outrageous.

- A) Retainage was almost always held at 10 percent. Final payment may take up to 15 months (Federal policy on direct federal construction indicates retainage should not be withheld routinely, but on a case by case basis.)
- B) Median time for payment was 46 to 60 days with several contractors reporting that payment took over 90 days.
- C) The biggest problem cited was slow payment on progress payments and retainage. Two other major problems were paperwork and slow decision making.

Length of Time for NAPHCC Contractors to Get Paid

	<u>Progress Payments</u>	<u>Final Payments</u>
30 days or less	27%	-
31-45 days	32	7%
46-60 days	23	11
61-90 days	10	11
more than 90 days	5	71

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National Association of Plumbing-Heating-Cooling Contractors

Pride In Our Past—Faith In Our Future

Position Paper

D7

DOUBLE BREASTING LEGISLATION

NAPHCC POSITION

NAPHCC strongly opposes legislation which would restrict competitiveness in the construction industry by redefining single employer. It would limit the freedom of investment and ownership, destroying the right to choose business opportunities.

BACKGROUND

Legislation under consideration by Congress would redefine single employers and compel management to apply pre-hire agreements to workers. The legislation would prohibit common ownership of two or more enterprises with different labor relations even though the companies are kept completely separate.

1. Restricts free enterprise by preventing the contractor from operating both a union and a nonunion operation.
2. Weakens our current labor laws in the respect of the decisions of individual workers and the assurances of workers to have the control of their own destinies through the collective bargaining process. This would be a significant departure from our current National Labor Relations Act.
3. Limits potential market of both a union and a nonunion contractor. By doing so, it limits job security for both a union worker and a nonunion worker.
4. Broadens the existing pre-hire exemption now found in the National Labor Relations Act.
5. Limits common control which could permit common situs picketing on jobs under common control of a prime contractor. The restrictive nature of the legislation will force contractors and construction jobs to be completely union or completely nonunion regardless of the competitive role in the marketplace or the preferences of workers.
6. Forces pre-hire agreements onto employees which could subject them to union contracts which they have not agreed to.
7. Has potential adverse effect on the effectiveness of the NAPHCC to adequately represent our members due to the great risk of losing members because of the obvious need on their part to make a decision to choose union or nonunion status of their business.

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National Association of Plumbing-Heating-Cooling Contractors
Pride In Our Past—Faith In Our Future

Position Paper

E2

PROMPT PAYMENT

POSITION

NAPHCC supports prompt payment of bills by all state and Federal programs, and Federal assistance programs.

BACKGROUND

NAPHCC members are involved with the Federal and state government as direct contractors, subcontractors and indirectly through state and local governments receiving Federal assistance. Payment delays therefore are of great concern.

Existing law should be modified to extend prompt payment to Federal assistance programs. NAPHCC specifically supports provisions for:

- Prompt payment requirements applied to progress payments
- Payment of interest on overdue accounts where payment is not made within 30 days after the invoice is received by the agency
- Interest to be paid out of the delinquent agency's operating budget with no additional authorization allowed to cover interest payments

Under Federal assistance programs, there is difficulty in determining just where a delay occurs. However, a contractor should not be penalized by late payments because he's at the end of the line. This adversely affects his cash flow and contributes to instability within the industry.

This is devastating not only to the businesses comprising NAPHCC but also to the Federal and state government which may be losing talented contractors who cannot afford or no longer want to do business with the government.

Thus, both the state and Federal governments and programs which they assist should be required to pay bills promptly just as in private transactions. Payments not made in a timely fashion should be subject to interest charges at prevailing rates.

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National Association of Plumbing-Heating-Cooling Contractors

Pride In Our Past—Faith In Our Future

POSITION PAPER

G1

Fair Competition

POSITION

NAPHCC supports action by Federal and state governmental agencies and public utility commissions to scrutinize carefully the operations of large business utilities and to prevent unfair or anticompetitive impact on small business contractors.

BACKGROUND

Members of our industry have been threatened by increasing competition from utilities in the sales, service and installation of equipment and materials traditionally the realm of the plumbing-heating-cooling contractor. While we fully support fair and open competition as a basis for our free enterprise system, we are deeply concerned that the activities of the utility companies are unfair and anticompetitive. These large business monopolies are abusing their rate payer supported position and are adversely affecting both competition and consumers.

The problem is enhanced by the Residential Conservation Service (RCS) and the Commercial and Apartment Conservation Service (CACS) which encourage greater utility involvement in our markets. In the guise of promoting consumer interest, they, in fact, promote greater consumer injury, particularly in a period of high energy costs. While certainly some customers may benefit from these programs, there are far more who are subsidizing them through the rate payer base. Some of these are the poor, senior citizens and others on a fixed income who can ill afford current energy prices, let alone pay more to help utilities to expand their monopoly over the market.

The problems with competition from utilities are not isolated to the plumbing-heating-cooling industry, but also reach to a variety of other contractor and retail groups, and are also of deep concern to supplier and manufacturer groups. Certainly, it is time to reexamine the role of utilities as publicly regulated monopolies and their impact on free enterprise highly competitive businesses.

NAPHCC urges the Federal Trade Commission and the Antitrust Division of the Justice Department to pursue cases of monopolization of markets and anticompetitive activity which is in violation of the antitrust laws.

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ATTACHMENT D (cont'd)

To determine the proper role of utilities, Congress should continue to conduct oversight activities on the practices of utilities and their effect on small business. Legislation should be developed which provides that utilities will not be permitted to use their monopoly market position to compete unfairly. While NAPHCC supports energy conservation, the Residential Conservation Service (RCS) and Commercial and Apartment Conservation Service (CACS) should not provide utilities with unfair market advantage. The programs should either be eliminated or revised to protect against unfair competition. In addition, no changes should be permitted to the Public Utility Holding Company Act that would make it easier for public utilities to diversify into non-utility industries.

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National Association of Plumbing-Heating-Cooling Contractors
Pride In Our Past—Faith In Our Future

D1

Position PaperMANDATED BENEFITSPOSITION

NAPHCC opposes efforts by government to mandate to employers the health or disability benefits to be offered to employees.

BACKGROUND

Federal and state governments require employers to participate in unemployment insurance, workers' compensation and social security programs. Each provides benefits to current or former employees. They are paid for by employers based on wages paid to employees. Their cost can be readily included in the cost of doing business.

Together, they provide a basic safety net of employee benefits. Many employers voluntarily provide additional benefits for vacation, health insurance, sick leave, etc. However, these are employee benefits which either are collectively bargained for or are offered by employers to be competitive in the labor market.

In recent years, there has been growing interest in Congress to mandate that employers offer additional specific benefits to present and former employees. In 1985, Congress required that employers permit former employees to continue participation in the employer's health plan at the former employee's own expense. Since then, proposals have been introduced to require employers to pick up that expense.

Other proposals have been introduced to require employers to grant extended leave for disability or parenting responsibilities. Initial proposals call for unpaid leave, but others have proposed that employees on leave be paid.

These proposals undermine the free enterprise system. Since all employers will be offering similar benefits required by law, they will be less competitive in attracting new employees. Furthermore, the cost of these benefit programs will be more difficult to estimate and to include in business cost. Several key employees taking leave simultaneously or unexpected high turnover could quickly turn a successful business into bankruptcy.

Although employment is a key element of many insurance programs, it does not mean that loss of a job means loss of health insurance. First, many employers provide extensive health coverage for their employees upon layoff. For most employers, the continued coverage ranges from one to three months which effectively provides protection for about two-thirds of the unemployed. Most state insurance codes require employers to offer continued enrollment at employee expense to all employees who leave the job. Some employers not covered by state codes exercise this option. Many of the unemployed come from households in which some other member is the source of group health insurance. Overall, two-thirds of those families with an unemployed member have someone else in the family who is working.

Finally, the unemployed may purchase their own health insurance and may be eligible for either medicare or medicaid assistance.

There are unique problems for the construction industry if a Federal program mandates that employers pay for extended health coverage to the unemployed beyond what already exists. By nature, construction is a seasonal occupation and workers expect to be unemployed for stretches of time. The high wages in construction are partial compensation for periods of inactivity. Also, given the high turnover rate in construction, often exceeding 300 percent, the cost of providing health insurance to the revolving door employee could break many employers and lead to even higher unemployment.

Some of the key problems in this regard are the questions of eligibility and duration of benefits. How long should an employee have to work before he could take advantage of extended health care benefits? Additionally, how long should the benefits last?

The enactment of new health legislation such as proposed would pose new problems for employers and private sector health plans. At a time when many collective bargaining health and welfare plans in the construction industry are already faced with economic difficulties (due to reduced contributions), the imposition of additional cost could be tragic.

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TESTIMONY

of

JoAnn H. Price

Chairman of the Board of Directors

of the

Small Business Legislative Council

Before

The Committee on Small Business

United States Senate

February 25, 1987

My name is JoAnn Price and I am the chairman of the Board of Directors of the Small Business Legislative Council (SBLC). I am accompanied today by John Satagaj, President of the SBLC. SBLC is an independent, permanent coalition of ninety trade and professional associations who share a common concern for the future of small business. Together, our member associations represent the interests of over four million small businesses. The unique characteristic of the SBLC is that we represent nearly every segment of the economy and we do so through the associations. As a result we quickly focus on how a public policy will effect different segments of the economy. However, we have never lacked issues upon which we all agree. The common denominator of small business is a strong bond. Our diversity, combined with our common commitment, permits us to offer a unique perspective on the concerns of the small business community.

First, on behalf of our organization, I wish to congratulate you on your selection as Chairman of this Committee and I would like to pledge our support and cooperation. We anticipate an active 100th Congress and thus expect many challenges.

This hearing is a timely one as we have just completed our 1987 Issues Conference. At the conference, SBLC members reviewed and discussed more than thirty policy recommendations. At the end of the day we ranked our recommendations in priority order. The final results constitute our agenda for the 100th Congress. Before I discuss these issues, I would like to establish a framework for our agenda.

Free enterprise was more than an economic theory in the early years of this nation, it was both a dream and a practical necessity. It inspired entrepreneurs and our society to seek out true economic independence, which resulted in the expansion of geographic, economic and societal horizons. The

entrepreneurial spirit, indeed, was the central plank of the economic platform upon which this country was built.

Once you get beyond the rhetoric, however, what role does small business play in our society and economy? Does small business get the recognition it deserves—not in 4th of July speeches, but in the corridors of power in Washington, in the financial markets and in the international market? Is national economic policy shaped around small business or is small business left on the sidelines until the game is over? Can we further expand the small business sector by charting a thoughtful, meaningful framework for the future of small business? The challenge for small business is to create an economic policy structure before the year 2000 which responds to small businesses, rather than ignores it. In the true entrepreneurial spirit, small business must tap its resourcefulness and creativity to establish a far reaching, innovative policy agenda.

Thomas Jefferson was a proponent of a lean, streamlined government providing a few essential services. The impact of the Federal government in his day was virtually non-existent on small business. Today, government has extended its tentacles into nearly all aspects of small business and has a profound impact on the bottom line of small business. It is the nature of entrepreneur, fiercely independent, to resist intrusions into his/her daily life.

Ironically, small business sends a somewhat conflicting message on the role of government—please stay out of my business, but help me with concerns which are beyond my resources. This is a theme, however, which is not inconsistent with the emphasis placed on the roles of the individual and society by the framers of our constitution.

The task for the year 2000 is to shape a government policy of balance. The balance in question is between the advancement of social, health and environmental goals and permitting small businesses to function and compete in the marketplace. The startling fact is government is not yet a sophisticated regulator. An understanding of small business has not been woven into the fabric of national policy making.

For example, the plea for "tort reform" is a manifestation of a desire to return to the application of the notion of common sense, not only in the civil justice system, but in our society as a whole. A call for less government is a call for a more sophisticated government.

The "more government" side of the equation is recognition of the fact the government does have a role in "jump starting" the engine of small business. If one looks at the programs which small business has endorsed, whether they be tax based incentives or lending programs, they are nearly all directed to the early, formative stages of small business when the internal resources of the business are limited. The formula is not complicated. Help small business over the initial hurdles and wait to reap the fruits of our efforts. The dividends of such programs are clearly justified by the ultimate job creation ability of small business.

Small business is a community of individualists. Visionaries, dreamers, optimists, entrepreneurs, call them what you may, they share a desire to step out in front and take hold of their destiny and the economy's destiny. It is difficult to quantify the value of economic freedom to individuals but no one questions this value as an important element of our society. The term quality of life is a phrase which comes most readily to mind.

Economic freedom however also brings with it the fruits of the quest. Competition leads to innovation and technological advances which in turn lead to enhanced productivity. It leads to a robust economy, ahead of the world rather than behind it.

In the year 2000 we should have secured the reality of equal opportunity of economic independence. Our policy must be shaped so that anyone who desires to exercise the right to own, operate and manage a business can do so.

Economic freedom also yields economic diversity. In the idiom, America may have taken its eye off the ball. Mergers, takeovers and acquisitions have become an obsession and the goals of such activity are no longer clear. Concentration of marketshare does result in more than increase the cost of goods to the consumer. Ask any town dependent in a single mill or plant, why economic diversity is important. Economic diversity is a source of stability. Each community should have as its goal the creation of a economic base which can withstand the loss of jobs resulting from the demise of a single business. By the year 2000 we should have implemented policies to successfully diversify and stabilize our national and local economies.

The entrepreneurs who founded this nation and made it prosper had it right the first time. We are a community of individuals, each of us with our strengths and our freedoms but moving together towards our common goal as a nation. Our economy is at its soundest as a community of small businesses, each as a competitor, innovator and job creator. In 1987, we can say small business is getting the job done but is it chance or policy? Can we make it better?

Small business must be the center piece of our economic policies not the show piece. National policy must be shaped around our understanding of small business. Small business should not have to cope with policy, they should prosper under policies. Our goal is to shape a framework that recognizes that our future, as has our past, must be invested in small business.

Looking to that future, however, we are not as confident about the status of small business in the economy of the future. It will be more than a year before we feel the first effects of the Tax Reform Act of 1986 and it will certainly be many years before we feel the full impact. In our organization there was considerable opposition to the bill as it made its way through Congress. One specific concern, expressed at the time, was the disproportionate negative impact of the bill on small corporations. These are the firms which constitute the innovative, job creation sector of the economy and these are the firms which must go head to head with the mega firms. The Tax Reform Act of 1986 challenges some the fundamental principles of how tax policy allows these firms to compete and expand.

We are particularly fearful of the impact of tax policy in light of the restructuring of economic power which has taken place through mergers and acquisitions. The small business sector has not yet felt the squeeze resulting from the merger and takeover activity of the last few years. It is our view the impact cannot be measured accurately with the economic analysis currently in fashion. We hope this Committee will look at the long term picture for small business. Combined, the twin towers of tax policy and antitrust policy represent powerful forces which will alter seriously the economic landscape in the 1990's and in the twenty-first century if we do not act now.

We hope this Committee will aggressively pursue the small business agenda beyond the four walls of the committee room. Small business needs advocates where ever we can find them. Many of the issues before us are not within the legislative jurisdiction of this Committee, but we do need someone to represent us effectively before committees in which our issues do fall such as Finance and Governmental Affairs. We hope you will work on our behalf; you can be sure you will have our support.

We have thirty recommendations to offer to you today. They are the culmination of three months of SBLC committee meetings and the final deliberations at our annual meeting. They cover diverse subjects from antitrust to procurement. They are remarkably consistent with the results of the White House Conference on Small Business and the agendas of our colleagues within the small business community such as NFIB, NSBU and the Chamber's Small Business Council. In that regard, I believe you will find small business united in its efforts.

I will not discuss all of our issues in detail but I would like to highlight a few recommendations. The top priority of SBLC in 1987 will be opposition to government mandated benefits. These benefits cover a spectrum of initiatives from parental leave to health insurance. Small business objects to such mandated benefits not only on the basis of the cost but also because they inhibit management flexibility. In a small business, such flexibility can make the difference between success and failure. The emergence of the concept of mandated benefits is disturbing. We believe it is indicative of a trend to push more of the responsibility for societal goals upon the shoulders of small business. We believe small business is already responsive to the needs of its employees. Small businesses are certainly more dependent on each employee for the overall successful and

smooth operation of the business. We also believe small business assumes its share of responsibility to the community and society. Therefore we must ask the question: At what point will we reach the breaking point for small business? In addition to the mandated benefits, there are new discussions on increasing minimum wage, passing stringent employee notification laws and banning the use of polygraphs to name just a few of the items already placed on the table in the 100th Congress. Each of these legislative initiatives exacts a price; in the aggregate the price may be more than the small business community can bear.

Our second recommendation represents our views on tax policy for small business. As I stated earlier, we were not fans of the Tax Reform Act of 1986. In this recommendation we have attempted to establish what we view to be an appropriate taxation and capital formation policy which will promote the growth of small business. Included in the capital formation section is a recommendation to enact legislation to create the Corporation for Small Business Investment (COSBI). As you know, COSBI nearly passed in the 99th Congress. We hope it will move quickly through the 100th Congress. We believe it is the prototype for small business assistance in the future. The return on the resources devoted to small business investment companies, in terms of job creation, justifies the effort.

Our third recommendation cites the need for comprehensive tort reform and the passage of uniform product liability legislation. While the tort reform/insurance regulation crisis may be ebbing, the systemic flaws remain and we must address them.

Our fourth priority is the enactment of further spending reductions and tough laws to create a balanced budget/deficit reduction process that works. Also included in the recommendation is a statement in opposition to any tax increase, regardless of how "euphemistic" the nomenclature.

Our fifth recommendation calls for reforms of insurance industry regulation. Small business recognizes that all sides were to blame for the recent crisis. If we are to have affordable, available insurance in the future we must do more than revise the civil justice system, we must provide for a sophisticated regulatory scheme equal to task of managing a global industry.

I would like to mention just a few other recommendations of our issues conference. This Committee has already moved forward to help enact amendments to the Prompt Payment Act. We support your efforts and those of Senators Sasser and Tribble. Competition by non-profits, governments and regulated monopolies with small business is a growing problem and admittedly a controversial one. We hope this committee will help us find solutions and work with the Governmental Affairs Committee and the Finance Committee to explore alternatives. We have several recommendations which related to the professional and technical services industries. National public policy is simply not responsive to the needs of this growing economic section and frankly, the federal government is behind the curve whether it be revision of SIC codes or procurement policy for purchasing such services.

We have not devoted much of our testimony to the Small Business Administration. We hope that it is a battle we do not have to fight this time around. We are pleased the Administration has not recommended "zeroing out" the agency. We hope the details can be worked out to preserve programs such as the Small Business Development Center program which are proven winners. We are optimistic such will be the case.

Our full list of recommendations follows. As you can see, the agenda is a full one, but a manageable one. We believe it is realistic but also looks to the future. As I said at the outset we are looking to what lies ahead for small business in the year 2000.

Priority Number 1

MANDATED BENEFITS. There should be no government mandated employee benefits. Rather, Congress and the states should explore creative alternatives for the private sector, including tax favorable incentives for encouraging the provision/expansion of employer-sponsored health care and other employee benefits.

The Small Business Legislative Council supports the following actions:

1. Rejection of any type of mandated benefits.
2. Equalization of self-insured and fully insured health plans with respect to existing mandated benefits.
3. Exploration of alternatives that retain a voluntary flexible benefits system and at the same time enable employees to fulfill their job and family responsibilities.

Small businesses are less likely than large businesses to provide employees with health and other fringe benefits, primarily because of relatively higher funding and administrative costs. Mandated benefits impose additional costs and are likely to further widen the gap between large and small businesses.

For almost a decade the states have been imposing hundreds of requirements on commercial health plans. The laws vary from state to state, but generally pertain to three areas: inclusion of specific services, such as mental health care; coverage of certain providers, such as chiropractors; and coverage of certain individuals, e.g., widows, who may purchase health insurance at group rates through the employer.

Under the Employee Retirement and Income Security Act of 1974 (ERISA), the Federal government is responsible for regulating self-insured plans. This distinction is important because while most small employers use traditional health insurance and therefore must pay for mandated benefits, the majority of large employers are self-insured and not subject to these state requirements.

Recently the Federal government has turned to the employer and has imposed mandates similar to those passed by the states. The first Federally mandated health benefit was included in the Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA). Employers with twenty or more employees with an employer-sponsored health plan are required to offer coverage to divorced spouses, widows, certain dependents, and employees terminated for any reason short of gross misconduct.

Other Federal proposals introduced in the 99th Congress included: continuation of the employer's contribution for laid-off employees for four months; mandated family and medical leave, including continued health insurance during a worker's absence; and the establishment of state risk pools, with the pool's losses financed by an employer tax. Proposed Federal legislation would typically disallow an employer's present health care tax deduction unless a particular benefit was provided, or specified group covered.

Priority Number 2

COMPREHENSIVE TAX FORMULA FOR SMALL BUSINESS GROWTH. The small business community will often be particularly hard hit by specific provisions of the Tax Reform Act of 1986. Small corporations will receive smaller reductions in corporate rates than large corporations under the 1986 Tax Reform Act. They will be adversely affected by the elimination of the investment tax credit, capital gains, and extension of depreciable life of capital assets. SBLC continues to strongly recommend enactment of the following proposals which are necessary if small business is to operate effectively.

1. Payroll Taxation. SBLC supports changes in payroll tax deposit rules to ease the burden of payroll taxes on small firms while in no way reducing the responsibility of the business owner, including amending IRS regulations by increasing the threshold for making payroll tax deposits from current levels; consider employers with gross annual deposits of less than \$75,000 to have complied if the deposit is not less than 90 percent of the taxes for the period; and other provisions.

2. Accounting. SBLC also supports simplified accounting and inventory valuation rules that will foster capital formation and retention, including (A) increasing to \$10 million in annual sales the limitation for firms which can use simplified LIFO pooling rules; (B) permitting any small business to use a single inventory pool and a single price index for determining the LIFO deferral; (C) allowing any small business, including manufacturers, to elect the cash method of accounting if gross sales are less than \$10 million; and other provisions.

SMALL BUSINESS GENERAL TAX RATES

Small business is often labor and inventory intensive. Thus payroll, income, and other taxes are at extremely high effective rates—far in excess of the average for all businesses. SBLC supports the following tax changes:

1. Rate Progressivity. The Tax Reform Act of 1986 imposes a new general rate structure which greatly lessens the progressivity of the previous system. As a result, its provisions often fall most heavily upon small business. This is especially true of the "recapture" provisions which impose an artificially high rate on earned income between \$100,000 and \$335,000. SBLC urges enactment of a directly progressive rate scale which would eliminate recapture provisions entirely, or alternatively, a rate scale which would shift the burden of revenue "recapture" to wealthier, higher income taxpayers.

2. Taxation of Fringe Benefits. Members of Congress and the Administration have discussed tax changes which place limits on the amount of fringe benefits received by employers and employees, including use of motor vehicles, medical expense premiums in excess of a cap and all other premiums paid by an employer. The taxation of premiums for these coverages is certain to result in cancellations of many plans and reduction of benefits, many of which are not generally available to individuals. SBLC opposes taxing individual employees or employers for the imputed cost of group life and

medical insurance, and for other essential fringe benefit programs.

3. Social Security. The Social Security system must be put on a sound financial footing. SBLC opposes (A) the use of general revenues for funding the Social Security system, and (B) any additional increase in social security tax rates applied only to employers.

CAPITAL INVESTMENT FORMATION AND EXPANSION

In recent years small business has become the "engine" which has sustained this nation's economic growth and expansion. The small business community currently accounts for more than forty percent of the gross national product and is responsible for more than two thirds of all new jobs which have been created. Yet its ability to maintain and expand this crucial role is vitally dependent upon adequate supplies of investment capital. Competition for such funds is often unfairly structured against small business. Our national economic welfare demands that government tax and investment policies actively promote greater levels of small business investment and expansion. Specifically, SBLC endorses immediate legislative enactment and administrative implementation of some reasonable "mix" of the following proposals:

1. Capital Gains Taxation.

- (A) A federal capital gains tax provision restoring a meaningful differential must be enacted to assure adequate availability of equity capital for new and growing small businesses. A low capital gains rate with a significant differential is also needed to attract senior management talent for young, growing companies. The failure of the recently enacted Tax Reform Act to not retain a permanent long-term capital gains differential will make it extremely difficult for independent companies to obtain much needed growth capital and award risk taking managers as it highly favors listed, dividend bearing securities of larger businesses.
- (B) There should be enacted a provision permitting the deferral of a capital gains tax liability provided the proceeds from the sale of a capital asset are reinvested in a qualified small business concern. A "rollover" provision would serve as an incentive to invest in long term, illiquid and higher risk, but nevertheless innovative, job producing companies that now find it very difficult to tap the equity markets. The proposal is analogous to the tax treatment afforded homeowners on the sale of a residence. SBLC supports the concept of a capital gains tax deferral on reinvestments in small business and urges Congress to pass legislation amending the Tax Code to create this incentive for investment in small firms.

2. Tax Credits and Expensing of Assets.

- (A) The SBLC strongly endorses enactment of a program of Capital Cost Recovery Credits. Such a program would provide appropriate tax credits for investments in new and used machinery and equipment. It would, however, be targeted on a limited, graduated basis to all forms of small business, including retailing and wholesaling.

- (B) Direct tax write-off for investments in small business by individuals. This tax change would permit individual investors to take a deduction of up to \$15,000 on their tax returns (\$30,000 on joint return) for a direct cash investment in qualified stock of a small business concern. The small business could sell up to \$250,000 worth of stock having this tax benefit. SBLC proposes a series of qualifications and safeguards to ensure use by the intended range of small firms and to prevent abuse, and urges Congress to amend the IRS Code to create this new incentive for investment in small business.
- (C) Direct and immediate expensing is of critical concern to small business. Proposals which will achieve this goal include more rapid accelerated depreciation, increasing the levels of the current immediate expensing provisions for small business or ultimately enacting a comprehensive direct expensing system for all capital assets.
3. Government Support Programs. Governmental efforts at a variety of levels can provide positive assistance to small businesses in their efforts to raise adequate capital for expansion and growth. Among the various suggestions which SBLC would endorse are the following:
- (A) Corporation for Small Business Investment (COSBI). COSBI would be a privately-owned and managed, federally chartered corporation which would act as a "capital bank" for the minority and small business investment company industries. This new financial intermediary between the private capital markets and the SBIC industry would replace government funding of the SBIC program with funds from the private sector. In addition, SBA's involvement in the SBIC and MESBIC programs would be terminated and replaced by a more efficient and more business-like self-regulatory system managed by the new corporation. SBLC urges Congress to pass the enabling legislation to create COSBI as soon as possible.
- (B) Small Business Participating Debenture (SBPD). The Small Business Participating Debenture is a new form of hybrid security designed to generate significant amounts of capital investment in small business on terms attractive to both the small firms and investors. It would combine certain debt characteristics (such as an interest rate and maturity date) with equity-type characteristics (such as a share in the net profits of the issuing enterprise). The major benefits of the SBPD concept to the small business and investors are tax consequences. SBLC supports the concept of SBPDs and urges passage of legislation by Congress as quickly as possible to amend the IRS Code to create SBPDs.
- (C) Loan Guarantee Corporations. Federal or state legislative bodies shall encourage, authorize and approve the creative use of semi-public loan or guarantee corporations to meet the needs of small firms. This capital can be used for start-up, venture capital, business expansion, capital improvement, fixed asset financing, and/or intangible collateral financing. These vehicles shall be many, or multi-faceted and self funded revenue neutral items. It

should create a loan guarantee vehicle similar to Fannie Mae (FNMA) to meet the needs of small business.

- (D) Small Business Reinvestment Corporations (SBREC). Authorize the formation of small business reinvestment corporations to obtain capital from private and public pension plans and invest that capital in small business. Federal enabling legislation will provide that such investments comply with the prudent man rule for pension plan trustees.

4. Equitable Access. Surveys conducted by the American Management Association and National Association of Women Business Owners indicate that women business owners encounter discrimination in acquiring financing. While regulations issued by the Federal Reserve Board (FRB) to implement the Equal Credit Opportunity Act of 1972 should have eradicated barriers based upon sex (and other factors). FRB's rules generally exempt business credit transactions from the rules requiring notification, retention or records and inquiries about marital status. This exemption hampers the ability of enforcement agencies and women entrepreneurs to detect illegal discrimination, eliminates incentives for financial institutions to monitor their own practices, and makes it impossible for public policy makers to know whether they need to address discriminatory practices or other types of barriers to full access to credit. SBLC supports initiatives to ensure access of women-owned businesses to credit, including withdrawal of the current exemption of business credit transactions from provisions of the Equal Credit Opportunity Act.

Priority Number 3

TORT REFORM/PRODUCT LIABILITY. The Federal government should foster a civil justice system that will: retain fault as the basis for liability; base causation findings on credible scientific and medical evidence and opinions; eliminate joint and several liability; limit non-economic damages to a fair and reasonable amount; provide for periodic payments of future economic damages; and, reduce awards by collateral sources of compensation for the same injury. Further, the critical problem of product liability can only be resolved by passage of national uniform product liability standard legislation.

The issue of tort reform is a complex one and several factors contribute to the problem. We have become a litigious society and the rules of the game have changed over the years. Legal theories, upon which our system is based, have been slowly and subtly altered and now the cumulative impact is a system out of balance.

The problem extends to all types of business liability whether product, professional or general liability. The nature of the problem appears to be two fold regardless of the type of liability. First, we have obscured the concepts of negligence and accountability to the point that small business can no longer undertake an activity with confidence, no matter how responsible that action may be. And second, there appears to be only a limited link between the finding of fault and the awarding of damages.

Small business owners shudder at the thought of federal regulation. It is not a concept which sits well with them. Further, the two major contributors to the problem—the tort system and insurance regulation—have been tradition areas for State activity. As such, much of the reform could take place at the State level, but we stress the could.

This is now a national problem, and demands national attention. Can effective reform be achieved through Federal legislation? Possibly it can. The civil justice system was created primarily at the State level and its problems should be solved there. If we are to obtain relief in our lifetime however, we must have Federal action. Even with Federal legislation, State action will be needed to supplement the actions of the Federal government.

Product liability is a unique aspect of the tort reform crisis confronting this country. Each State applies widely varying standards to products in interstate commerce, and the current administration of civil justice as it relates to product liability creates chaos and ultimately results in higher costs to the consumer and businesses, without providing effective protection for the product user. Adoption of a uniform national standard for product liability must be a national priority.

Priority Number 4

DEFICIT REDUCTION AND FISCAL POLICY POSITION. 1. Since 1981 the national debt has doubled, reaching a total amount in excess of \$2 trillion. A debt of this size, and the magnitude of the continuing annual deficits which have created it, pose major threats to the economic health and security of the United States. They threaten to place substantial control of the United States economy into the hands of unsympathetic foreign investors. They divert substantial government capital into non-productive interest payments, now the fastest growing "program" in the federal budget. They cause massive competition between the government and the private sector for loanable funds, thus drying up important capital resources. This is especially damaging to small businesses already seriously handicapped in their struggle with larger, wealthier competitors for vital bank loans. Finally, in the absence of immediate crises, they place unacceptable risks and burdens upon future generations, virtually mortgaging their chances for prosperity. In summary, the federal government must act immediately and responsibly to control and ultimately reduce the national debt and the annual deficits which produce it.

2. Effective control over these burdensome federal budgetary deficits depends primarily upon constructive approaches to reductions in government spending. Unfortunately, the size and scope of countless government programs have reached levels which are totally unacceptable. For example, in the past five years the actual size of our federal bureaucracy, spending, and resulting deficit has continued its alarming upwards spiral. Total government employment has not come down but has increased from 4,966,000 in fiscal 1981 to 5,210,000 in fiscal 1986. Federal expenditures likewise have increased from \$590.9 billion to \$979.9 billion. The federal debt doubled by 1985 and has now crossed the \$2 trillion mark. Net interest on the debt has almost tripled, the trade deficit is now four times larger, and for the first time since 1959 the United States is now a net importer of food. This trend must be reversed.

The Gramm-Rudman-Hollings Act has provided us with a reasonable legislative timetable for final elimination of our annual deficits. Any efforts to weaken its schedule or "stretch out" its deadlines must be resisted. Prompt and timely action is a necessity.

It would be preferable if the Congress could carefully review each individual program and exercise thorough oversight judgment to reach reduced spending targets. However, if the pressures of politics and timing prevent such careful crafted review, then mandatory spending reductions should be imposed. The automatic "sequestration orders" issued by the Comptroller General's office in the original Gramm-Rudman-Hollings Act point out the proper direction. While this procedure was recently struck down by the Supreme Court in *Bowsher v. Synar* on a Constitutional technicality, innovative legal approaches are available to remedy these deficiencies without sacrificing the basic, automatic nature of the spending reduction process. (See, for example, the "Gramm-Rudman-Hollings II, Perfecting Amendments" offered in the 99th Congress, 2nd Session (1986), 132 CONG. REC. S9840). Strong support should be given to legislation which restores automatic across-the-board reductions in federal spending in the face of Congressional inability or unwillingness to reach the legally required deficit levels set out in the Gramm-Rudman-Hollings Act.

3. In recent years the deficit issue has given growing prominence to a variety of taxation increase proposals such as a National Retail Sales Tax (RST), a Value Added Tax (VAT), a Business Transfer Tax (BTT), a Personal Expenditures Tax (PET), and a variety of Oil Import Fees (OIF). The SBLC believes that these plans would do serious damage to the national economy, the small business community, and numerous individual citizens without providing significant or meaningful solutions to the deficit crisis. We have strongly argued against their passage, and the Congress of the United States has agreed.

Any comprehensive and objective analysis of the proposals for tax increases discloses sound reasons for incurring strong small business opposition. In addition to general objections to unnecessary tax increases, including Congress' failure to first control federal spending, the proposals are unsound and insupportable, for these reasons:

A. Revenue enhancement cannot be allowed to serve as a direct or indirect excuse for federal spending increases. Proposed forms of added taxation have not provided specific legal guarantees that all revenues raised would be applied directly and exclusively to deficit reduction. This has been a major challenge to the legal structure surrounding all such proposals.

B. Proposed forms of higher tax burden will not significantly contribute to deficit control and are likely to be far more disadvantageous to business and administratively costly than its minor benefits. Proposed tax increases have failed to guarantee reductions in budget deficits.

C. Proposals to increase taxation have fallen more heavily upon the nation's small businesses and have been unjust and unproductive and have not applied fairly and progressively to the individuals and/or businesses affected.

D. Complex and costly administration has been particularly burdensome to the millions of small businesses throughout the nation. The administrative and reporting requirements involved in taxation proposals are complex and expensive.

E. Any slowing of economic growth will only produce substantial hardships as well as counterproductive shortfalls from other revenue sources and increases in federal assistance spending. New tax proposals have failed to avoid any major negative impacts upon national economic growth as they adversely affect employment, investment, consumption, or planning.

F. The dangerous precedents involved must be fully considered. While initial suggestions often involve specific exemptions in categories of taxpayers or goods, certainty that over time there would not be a dangerous erosion of such provisions has not been assured.

In summary, Congress must recognize that as a solution to the national debt crisis, new forms of taxation or rate increases pose the most serious dangers to the economic health and welfare of our national economy, the entire small business community, and the vast majority of our individual citizens.

Priority Number 5

CASUALTY INSURANCE. The ability to obtain casualty insurance at reasonable, affordable prices continues to be a problem faced by small businesses and individuals throughout the nation. The current crisis is a recurrent characteristic of the insurance industry manifested about every eight to ten years. The present crisis may linger longer in the crisis phase than has been true in past cycles.

The costs surges and non-availability of certain lines of insurance follow periods of highly competitive, possibility predatory behavior of the insurers in seeking premium dollars for investments, especially during periods of high returns on capital. These cyclic periods of below-cost sales of insurance products (termed cash flow underwriting) appear to be repetitive, irrational behavior.

Regardless of where blame may properly rest, this current crisis has resulted in severe losses to certain elements of the insurance industry in addition to thousands of insureds, particularly small businesses, depending upon this product, have experienced price shock and unavailability of insurance. The cyclic behavior, the absence of any national oversight, and the dearth of data suggest the need for federal examination and study of the insurance industry.

Effective state regulation of these national and international corporations cannot be accomplished without improved centralized data-gathering from which state regulators and legislatures can obtain meaningful information needed to regulate the insurers.

Both federal and state antitrust principals must be applied to the extent possible in judging the behavior of the insurance industry. The scope of the

McCarran-Ferguson antitrust exemption for the insurance industry must be carefully reexamined. Small business recognizes, however, the need, particularly for small insurers, to have available adequate data to compete. The Federal Trade Commission should again be authorized to study and investigate the activities of this essential industry.

The main concern of small business is to ensure the continuous availability of competitively priced insurance through the stability and solvency in the insurance industry. A federal centralizes data activity which can assist the states to effectively regulate the business of insurance or state promulgated regulations, prohibiting insurers from directing insureds to specific providers of goods and services except upon written requests of insured, are examples of actions which will achieve such goals.

Priority Number 6

STATEMENT ON INTERNATIONAL TRADE POLICY. The participation of small businesses in the international market represents an important and fundamental criterion for the resurgence of the United States trade position. The following areas must be addressed and policies adopted in order to ensure "fair" trade for U.S. firms in the world market:

- a. Financial and management assistance to enable more small businesses to compete in the international market.
- b. Removal of barriers to international trade, such as licensing, specification and nationality requirements not otherwise imposed on domestic firms.
- c. Measures to encourage small firms to export, such as stronger patent and proprietary data protection as well as programs to assist firms to convert to the metric system.
- d. Stricter and more thorough enforcement or improvement of current United States fair trade laws.
- e. Adoption of a clear and forceful international trade policy, either through creation of a cabinet level position or enhanced coordination and focus of current policy-makers.
- f. A right of private action with compensation to the injured party should be created to enable access to remedies by small business. A "short form" expedited, low cost proceedings before the ITC should be established.
- g. The Standard Industrial Classification (SIC) code should be massively overhauled so that it will evolve with the continuing diversification and growth of the American economy, and provide timely information to policymakers and business users. In addition, a Commission on Services, Information, and High Technology should be created by Congress to recommend statistical, trade, tax, procurement and other policies which will enhance America's competitiveness, both internationally and domestically.

Priority Number 6

FAIR COMPETITION. In order to protect small businesses, and consumers, from damaging levels of unfair competition, federal, state and local laws, regulations and policies should:

- a. Prohibit unfair competition in which non-profit tax-exempt organizations use their tax-exempt status and other advantages in selling products and services also offered by small businesses.
- b. Prohibit direct, government-created competition in which government organizations perform commercial services.
- c. Prohibit government sanctioned monopolies, such as utilities, from using their monopoly resources to compete in other markets.

These goals should be achieved in, but not limited to, the following ways:

Non-profits: Tax-exempt entities should not be permitted to use their tax status or postal rates to compete with commercial providers of products and services. Non-profit organizations receiving government grants and contracts, including Federally Funded Research and Development Centers, should be prohibited from using federal dollars to compete with products and services provided by the private sector. Non-profits engaging in commercial activities should be prohibited from doing so while enjoying exemption from government regulations such as antitrust laws, worker's compensation, and health and safety rules.

Governments: New laws at all levels, particularly at the federal level, should require strict government reliance on the private sector for performance of commercial-type functions. When cost comparisons are necessary to accomplish conversion to private sector performance, laws must include provision for fair and equal cost comparisons. Funds controlled by a government entity must not be used to establish or conduct a government operated commercial activity on U.S. property. Further, public funds extended by federal, state, and local government must be utilized, to the extent feasible, to contract for goods and services from the private sector.

Utilities: Government regulated utilities should be prohibited from using their government favored position to compete in markets already served by small businesses.

Priority Number 7

SMALL BUSINESS ADMINISTRATION. The SBA must maintain its status as an autonomous agency whose sole mission should be to advocate for and assist the small business community, with the private sector's having a stronger partnership role. SBLC recommends (1) strengthening the independent role of the Office of Advocacy; (2) mandating a comprehensive review of all SBA programs conducted under the leadership of the small business constituency; (3) directing SBA to increase its reliance on local resources in the private

business sector in the delivery of lending and management assistance services; (4) including the SBA Administrator on all Cabinet Councils affecting commerce, trade, and the economy; (5) expanding SBA's management and technical assistance to small business in regard to government regulations; and (6) requiring SBA to continue matching state SBDC resources and expand the SBDC program to all 50 states as prescribed by the Small Business Act, prohibiting SBA from requiring SBDC's to charge counseling fees, and forbidding SBA from adopting proposed SBDC regulations requiring national program uniformity.

Priority Number 8

ANTITRUST, MERGER AND PREDATORY ACTIVITY POLICY. The SBLC reaffirms its belief that the foundation of American antitrust policy must be a commitment to decentralized and deconcentrated economic and political power. Consistent with such a commitment is the creation of economic conditions in which both consumers and private enterprise enjoy optimal choice and opportunity created through active and fair competition. Therefore, ongoing enforcement of the broad mandates of existing antitrust laws should produce a diversified economy characterized by an abundance of small businesses, producing employment, innovation, and economic freedom. Congress must undertake long-range enforcement planning and monitoring which will deter economic concentration and anticompetitive marketplace activities. Specific SBLC recommendations include: (1) preservation of antitrust enforcement efforts through provision of appropriate authority and resources to agencies such as the Federal Trade Commission and the Department of Justice; (2) careful personnel review to insure that relevant policymaking officials demonstrate a genuine commitment to a meaningfully competitive marketplace featuring a healthy and expanding small business component; (3) diligent oversight of existing specific enforcement policies through utilization of recently passed legal reporting requirements as well as legislative hearings where appropriate; and (4) resistance to any statutory revisions which would weaken current laws, such the proposed "The Antitrust Remedies Improvement Act" which would seriously reduce the available damage remedies now serving as a strong deterrent to potential predators.

Merger Policy

The Department of Justice and the FTC have escalated a trend of permission for giant corporate mergers while simultaneously engaging in strong enforcement measure against relatively small mergers and acquisitions. Worse still, has been the introduction of statutory revisions, such as the Administration-supported "Merger Modernization Act," which would significantly weaken present Clayton Act restrictions upon proposed mergers. SBLC urges that the FTC carefully scrutinize mergers and acquisitions, particularly those involving larger corporations, and grant approval only when clear and convincing evidence supports the economic and social viability of such action. SBLC also urges that Congress decisively reject any legislative attempts to substitute standards of market power and economic efficiency for the broader, more desirable, condemnations of monopolies and anticompetitive practices contained in present statutes.

The Robinson-Patman Act

The Robinson-Patman Act forbids price discrimination between purchasers of goods of like quality in interstate commerce. A jurisdictional requirement of the Act allows action under the Act only where the price discrimination may lessen competition or tend to create a monopoly. Large buyers may claim a purchasing advantage, but this must be based on the cost-justified volume of their purchases. SBLC recommends that the "administrative repeal" of the Robinson-Patman Act must be reversed, funds specifically for Robinson-Patman Act enforcement need to be appropriated, and the Federal Trade Commission must be required to show the effects of its enforcement. Enforcement of laws to prevent predatory pricing must be reinforced, if necessary, by Congressional action, and vigorously enforced by the FTC.

Foreign Competition

It is possible that major trade reform legislation in areas such as "dumping" and economic subsidies can be created to assist the small business community. However, the rising emphasis upon "competitiveness" should be permitted to justify fundamental revisions of domestic antitrust statutes. SBLC believes that conclusive proof of beneficial foreign trade results in an essential prerequisite of any legislative alteration performed for this reason. Permission for more anticompetitive mergers at home will not fundamentally alter any relevant competitive conditions abroad. It will only seriously reduce the vitality of domestic competition, small business profitability, and consumer choice.

Priority Number 8

SMALL BUSINESS PARTICIPATION IN PROCUREMENT. A fair proportion of the purchases and contracts for goods and services required by the federal government should be awarded to small business concerns. The federal government's goal should be to contract with qualified small businesses in order to broaden the number, diversity, competitiveness and availability of competent and experienced contractors to support the public's needs. Small business participation should be a significant percent of the contract dollars for each industry; and eventually, it should reflect the level of small business contributions to the Gross National Product.

These goals can be achieved through the following actions:

- a. Distribute procurements, made through set-asides by federal agencies, across all categories of goods and services for small businesses. Distribution should be proportionate to small business share in each SIC Code based on the needs of the industry represented by the SIC Code.
- b. The federal government should develop a standard approach for setting size standards by SIC Codes based on sound economic data to ensure the size standards are equitable, rational, and consistent. Further, the government should develop procurement procedures that ease "graduation shock" for companies transitioning out of their small business size standards.

- c. Require that all agencies annually publish a 2-year procurement plan that identifies known potential procurements for small businesses and designates those to be set aside where appropriate.
- d. Require that all agencies annually publish a 2-year report on the number, size, and total contract dollars awarded to small businesses in each industry category.
- e. The federal government should assist small business concerns, especially those owned by minorities and women, to effectively compete for federal contracting opportunities as contractors or subcontractors by eliminating barriers such as prevailing wage laws (Davis-Bacon Act, Service Contract Act) and establishing incentives to foster expanded participation.
- f. Recognize that notwithstanding the fact that the "Rule of Two" can be an adequate standard for determining small business set asides in many industry categories, it does adversely impact certain industries; and as such, it should reflect the changes legislated by section 921 of the FY '87 Defense Authorization bill which establishes size standards and set-aside targets for those affected industries. Similarly, in other industries where small business has not received an equitable share of contract dollars, the rule of two must be enforced vigorously.
- g. Federal agencies should be encouraged to purchase products and services from local dealers as part of the Multiple Awards Program run by the General Services Administration. GSA should seek the inclusion of local dealers in multiple awards contracts to ensure that U.S. agencies receive adequate sales and technical advice, service and support.

Priority Number 9

DOUBLE-BREASTING LEGISLATION. Congress should not restrict competitiveness in the construction industry by limiting the freedom of investment and ownership. Congress should defeat proposed anti-double breasting legislation.

Legislation under consideration by Congress would redefine single employers and compel management to apply pre-hire agreements to workers. The legislation would prohibit common ownership of two or more enterprises with different labor relations even though the companies are kept completely separate.

1. It restricts free enterprise by preventing the contractor from operating both a union and non-union operation.
2. It weakens our current labor laws by limiting the decision of individual workers and the assurances workers have to control their own destinies through the collective bargaining process.
3. It limits the potential markets of both union and non-union

contractors. By doing so, it limits job security for both a union worker and a non-union worker.

4. It broadens the existing pre-hire exemption now found in the National Labor Relations Act.

5. Provisions limiting common control could permit common situs picketing on jobs under common control of a prime contractor. The restrictive nature of the legislation will force contractors and construction jobs to be completely union or completely non-union regardless of the competitive role in the marketplace or the preferences of workers.

6. It forces pre-hire agreements onto employees and would subject them to union contracts which they have not agreed to.

Priority Number 10

THE VOLUNTEER PROTECTION ACT. The current crisis of liability insurance has hit our organizations hard in many areas. One area that has been particularly vulnerable for non-profit organizations has been protection for volunteers that give their time and talents serving on boards, committees, and task forces for our organizations. As premiums for this type of liability coverage climb upwards of \$5000 to \$10,000, many organizations are forced to "go bare." Under these circumstances, many quality volunteers refuse to give of their time and look for less vulnerable opportunities.

One effort to remedy this situation was the introduction of The Volunteer Protection Act into 99th Session of Congress by John Porter (R-IL). The bill encourages states to extend civil liability immunity to volunteers working on behalf of non-profit organizations and only hold volunteers responsible for "willful and wanton misconduct."

The Small Business Legislative Council expresses its support for The Volunteer Protection Act, as proposed by Congressman John Porter, and urges Congress to adopt the Act at its earliest opportunity.

Further, SELC recognizes the need for state legislatures to consider and enact this bill to provide national protection and, thus, encourages those states that have not enacted volunteer civil immunity laws to do so at the earliest opportunity.

Priority Number 11

STRENGTHENING THE PROMPT PAYMENT ACT. The Prompt Payment Act of 1982 should be strengthened through an amendment which will:

- Eliminate the 15 day grace period;
- Require automatic payment of interest penalties;
- Define clearly that the entire payment process, including acceptance, must

occur within 30 days.

- Require that interest penalties be paid on late progress payments and retainage;

- Require that contractors pay their subcontractors and suppliers at any tier within seven days after receiving their payment;

- Prohibit the taking of early discounts unless the agency has complied with the payment terms;

- Mandate that prime contractors pass through to their subcontractors any late interest penalties received from the government;

- Extend the protection of the act to contractors under federally assisted programs, U.S. Postal Service Contractors, and Contractors providing goods or services to Medicare and other federal programs utilizing fiscal intermediaries;

- Require the annual reports on the implementation of the Act to provide more detailed information.

The Prompt Payment Act, as amended, must be enforced vigorously by all branches of government.

Priority Number 11

INCREASED SMALL BUSINESS COMPETITIVENESS THROUGH IMPROVEMENTS IN THE PROCUREMENT OF PROFESSIONAL SERVICES. Professional and technical services constitute a dynamic and fast emerging sector of the United States economy. The procurement of these services by the federal government has grown significantly in the past few years without a parallel expansion in the current acquisition system. The following steps should be taken to meet the emerging needs:

- a. The acquisition system needs to be redesigned to more efficiently acquire services, as opposed to goods and materials.

- b. Technical training of federal program and contracting personnel concerning the acquisition of professional and technical services is needed.

- c. Improved methodologies must be developed that emphasize quality in the procurement of complex and sophisticated services. If such services are acquired predominantly on the basis of lowest price without proper regard for quality, the government will in fact end up, in the long run, paying more, not less, for needed services. Additionally, this improved methodology which emphasizes quality will encourage greater innovation and productivity in private sector work for the federal government.

- d. Develop and implement on a demonstration basis a simplified alternative acquisition process that assures the federal government

the benefits of competitively procured services and increased access to the market for businesses of all sizes, including small business firms.

e. The federal government should utilize the 40 hour work week as the basis for competition for contract awards, to assure that the right balance is maintained between quality and cost/price factors.

f. The federal policy for profits should differentiate between manufacturing, research and development, and services to ensure adequate profits to encourage the private sector to compete for federal procurement opportunities.

g. The Standard Industrial Classification (SIC) code should be massively overhauled, so that it can evolve with the continuing diversification and growth of the American economy and so that it can provide realtime information to policymakers and business users. An appropriate methodology would allow for crosswalking between all major federal data systems; identify the amount of commercial economic activity performed in the not-for-profit, franchise and similar sectors; and be dynamically updated.

Priority Number 12

FINANCIAL SERVICES. The SBLC supports the legislative efforts to close the nonbank bank loophole and to promote the continued separation of banking and commerce.

By exploiting an unintended loophole in Federal law (the so-called nonbank bank loophole), commercial firms, including national retailers, are buying banks and S&Ls. Over time, this will threaten the impartial allocation of credit, promote enormous concentrations of finance and commerce and undermine the competitive position of various small business entities, including small banks. In his formal testimony before the Senate Banking Committee on January 21, 1987, Chairman Volcker outlined the stakes for small business. He stated: "Suppose we have our banking run by various commercial firms over the country with offices in retail chains and so forth. Will these banking offices serve the general needs of other borrowers in the local community. Suppose the local appliance dealer comes in there and asks for loans from a bank run by a large retail chain. I suspect that branch manager isn't going to be happy to provide the money to the local retail establishment. If he does, I suspect he is going to find himself selling shoes instead of running the bank offices before very long."

Volcker's statement underscores the threat of the loophole to the impartial allocation of credit. The small business community must also be concerned about the future supply of credit, since the nonbank bank loophole would allow any firm with nationwide offices to establish nationwide deposit-taking networks run from New York or Tokyo.

The exploitation of this loophole in the Bank Holding Company Act is a relatively recent phenomena. Chairman Volcker also testified that nonbank bank operations are still relatively small, that the horse isn't out of the

barn, if the Congress acts now. (This issue has been referred to SBLC's Antitrust and Economic Policy committee for additional consideration.)

Priority Number 12

HIGH RISK OCCUPATIONAL DISEASE NOTIFICATION AND PREVENTION ACT. The High Risk Occupational Disease Notification and Prevention Act, as proposed in the 99th Congress, established a new federal program to individually notify past and present employees who are 30 percent more likely than similar populations to develop an occupation disease. The employee is then encouraged to undergo medical monitoring and the present employer must pay for the tests unless that employer was not the one responsible for an exposure to the particular hazard associated with the disease. The bill also established an eight member federal Risk Assessment Board in the Department of Health and Human Services to assess health studies and determine which employees are in "30% risk" groups. Eventually, each state would have an occupational and environmental health center with research authority and access to all federal employment-related files.

The bill authorized a government expenditure of \$25 million for each of two years, but estimates are that the costs will actually be much higher. The government has not even assessed what the costs to the nation's businesses will be. In addition, the legislation would increase an already debilitating insurance crisis and escalate the liability suit crisis.

The bill placed administration of the program within the Department of Health and Human Services and the enforcement authority placed in the Department of Labor.

Moreover, there is no indication that the Occupation Disease Notification Act will give any protection. It merely requires the employee to be notified that if he has an occupational disease, it could have been caused by his occupation and it suggests medical monitoring.

The 30% excess risk factor is arbitrary and is a low correlation without any scientific cause and effect to base it on. In addition, there is not control factor to account for the effects of smoking and diet.

The proponents of the bill declare that its primary purpose is to detect and prevent cancer, but only five percent of cancers in our society are occupationally related as was pointed out in the minority report in the 99th Congress.

The need for addition health centers and expenditures of these federal dollars during this austere time has not been demonstrated. The few hearings held brought forth no testimony to indicate that current hospitals or medical clinics are incapable of medically monitoring or evaluating notified workers. Existing hospitals are capable of dealing with the medical needs of notified workers.

The Department of Labor, in May of 1986 broadened and strengthened the OSHA Hazard Communication Standard to require employers who manufacture, distribute and import hazardous substances to notify employees of health

hazards in the workplace and train those employees in how to handle those hazards safely. OSHA is in the process of expanding the scope of coverage of the rule to all workers exposed to hazardous chemicals. In addition, more than 35 states and localities have similar laws. This approach should be given a fair opportunity to work before we add a complex, costly, and untested program of post-exposure risk assessment and notification.

Priority Number 13

FAIR LABOR STANDARDS. Small Business has a substantial stake in national policies which have a significant effect on the cost of labor. Small business is a proven job creator and labor intensive. The SELC will not support proposals which will dramatically increase the cost of labor, in the absence of compelling evidence such initiatives will advance social and economic goals.

Federal policies which have a direct impact on the cost of labor evolved in response to particular concerns. SELC believes it is appropriate for Congress to reexamine whether there are alternatives which will allow employees to earn a fair wage, advance societal goals and allow small businesses to add new jobs in the economy. Rigid rules, which once made sense, no longer permit the U.S. to remain competitive and no longer serve the purpose for which they were established.

Priority Number 14

RETIREMENT, SAVINGS AND EMPLOYEE BENEFIT PLANS. Congress and the Executive Branch should eliminate those laws and regulations that discourage the creation and maintenance of retirement and savings plans by small business, and instead enact laws that encourage the creation of these plans.

The Small Business Legislative Council supports a voluntary, private pension system, and supports Congressional and Executive branch actions that would:

1. Repeal top-heavy rules
2. Establish contribution levels for small business plans that recognize that these plans are established to ensure the retirement security of the small business owner as well as his or her employees. These levels should be at least at the level established in the original ERISA legislation of 1974 for defined benefit and defined contribution plans, and at the pre-1987 levels for IRA's, and 401(k) plans.
3. Eliminate, or ameliorate, the bias against defined contribution plans, such as profit sharing plans, which are recognized as the type plan that is most likely to be established by small business. (For example, the Office of Advocacy of the Small Business Administration recommends greater encouragement of defined contribution plans in small businesses as the best way to increase private pension plan coverage to small business employees.) This bias was most evident in the 1986 Tax Reform Act, with its many provisions that complicate the

establishment and maintenance of defined contribution plans, such as severe restrictions on a participant's access to his or her money in such a plan.

4. Allow a small business to utilize comparable plans.
5. Eliminate all new taxes imposed on plans in the 1986 Tax Reform Act.
6. Reform the multi-employer pension laws to curtail or eliminate withdrawal liability for small business.
7. Stop needless, and theory-driven changes to the laws governing retirement, savings and employee benefit plans subsequent to the changes outlined below.
8. Examine the impact on small business defined benefit plans of altering pension benefit guaranty corporation premium system from a fixed uniform premium rate for all plans to a variable rate for plans based on plan funding.

Subsequent to the passage of the Employee Retirement Income Security Act (ERISA) of 1974, Congress and the Executive branch of government have enacted laws and regulations that discourage the establishment and maintenance of retirement and savings plans by small business. As a result, the number of employees of small business covered by any private pension plan has remained low when compared to the numbers of covered employees of large businesses. The new laws enacted since 1980 have made the situation worse. There is evidence that the number of employees of small businesses that are participants in a private pension plan, already low, is dropping even more. This trend threatens the very existence of the nation's voluntary private pension system. This trend may lead to misguided efforts to impose costly mandated pensions on small business, or to make small business pay even higher Social Security taxes.

Federal policy makers do not understand, or do not appreciate, why small business owners establish retirement, savings, or employee benefit plans; nor do they understand the vast differences between the small business plans and those same plans in big businesses. For example, the numerous, frequent, and complex amendments to the laws regulating these plans are devastating to small business because these changes impose very high administrative costs on the small business owners.

Priority Number 15

ECONOMIC POLICY: UNDERSTANDING THE NEW AMERICAN ECONOMY. Be it resolved that Congress shall establish a blue ribbon commission to identify the impact of services, information and emerging technology sectors of the American economy. This commission shall be composed of both private and public sector representatives, including members of Congress. Its mandates shall include:

- a. reviewing existing Standard Industrial Classification (SIC) codes to identify the magnitude of "America's Statistical Gap" and to make

recommendations with regard to appropriate federal legislation and regulations that will ensure proper classification for all industries; and

- b. reviewing all other aspects of federal policy affecting services and new technologies, including such areas as tax, credit and capital, regulations, procurement, research and development, intellectual property, trade, education and training, international competitiveness, measurements of productivity and loss of productivity due to problems with childcare.

The commission's final report to the President of the United States and to Congress would recommend a series of specific legislative and regulatory changes in data gathering, economic, tax, procurement, trade and other policies to foster, rather than impede, these dynamic new sectors of the economy.

Be it further resolved that Congress shall enact legislation directing the Executive Branch to create, as a successor to the SIC codes, a new data collection and dissemination system that will:

- a. evolve with the continuing growth of the American economy.
- b. allow for crosswalking among all major federal data systems-including but not limited to "old" SIC codes, government procurement systems, contract tracking, management information systems, and internationally traded goods and services-incorporating where possible all relevant international data systems.
- c. Identify the amount of commercial economic activity performed in the not-for-profit, franchise, and similar sectors.
- d. Be updated as to data collection methodologies on a regularly scheduled basis.
- e. Provide to the entire business community, through a specified governmental source, appropriate and timely access to all background information.

While the federal government produces bales of statistics, comparatively little useful information is available on economic growth, innovation and emerging sectors of the economy. This is because much of our economic data collection is based on antiquated assumptions and methods developed in the 1930's.

A prime example of what has been referred to as "America's statistical time warp" is the Standard Industrial Classification Code, a set of more than 1,000 four-digit numbers used to classify U.S. industries and keep tabs on economic output. Established in the 1930's and updated every 15 years, we believe the present SIC Code seriously underrepresents the new services, information and high technology sectors of the American economy.

The goods producing sector is represented by 599 different industry categories, though it provides only 27 percent of employment and 33 percent

of GNP. The newer services sector, by contrast, is represented by only 423 industry categories in the SIC, even though it contributes 70 percent of the jobs and two-thirds of the GNP. Older sectors of the economy such as agriculture are broken down in such rich detail that one can tell whether a tomato has been grown indoors or in a field. But in newer sectors such as services, a vast array of industries are listed under "services—not elsewhere classified"—a catchall which includes nuclear scientists and songwriters, art restorers and industrial psychologists, and cloud-seeding companies.

This outdated statistical framework is grossly inadequate to support development of sound economic, tax, trade, procurement and regulatory policies. The lack of sound data is a practical barrier to understanding the true nature, dimensions and character of the new American economy and its dynamic entrepreneurial sector.

While the Office of Management and Budget is expected to announce its 15-year revision to the SIC Codes in 1987, these are again expected to be modest revisions at the margin, which in the view of industry experts in newer sectors will still provide a "rearview mirror of the American economy."

Priority Number 15

POLYGRAPH LEGISLATION. The Small Business Legislative Council endorse federal legislation establishing minimum standards for the utilization of polygraphs in the workplace. Any such legislation must permit continued use of polygraphs for pre-employment screening, random testing, and incident specific testing. The administrative-regulatory requirements of legal compliance must be reasonable ones, and not so complex or expensive as to effectively preclude meaningful employment use. To the maximum extent possible, such legislation should treat all employers in an equal fashion and permit no substantive exemptions from its provisions.

An alternative legislation approach of minimum legal standards should be developed. As part of its provisions, it should:

- a. Set professional standards for polygraph examiners.
- b. Prohibit certain categories of inquiry such as political, sexual, or religious oriented questions.
- c. Set limits on the proper use of exam results (e.g., tests could not be the sole reason for dismissal or failure to hire).
- d. Preempt less stringent state regulations.

Priority Number 16

FULL AND OPEN COMPETITION IN FEDERAL PROCUREMENT. The small business community has championed full and open competition in the Federal procurement market in the belief that small business government contractors can efficiently meet the Government's requirements as prime contractors,

subcontractors, or suppliers. Such expanded small business participation fosters the competitiveness of American business and contributes to the maintenance of the Nation's defense industrial base.

Congress has responded by enacting fundamental procurement reform legislation to assure full and open competition in the federal market and to eliminate barriers to small business participation: the "Competition in Contracting Act of 1984", Title XII of Public Law 98-525; and the "Small Business and Federal Procurement Competition Enhancement Act of 1984", Public Law 98-577. However, it is essential that Congress closely monitor the implementation of these statutes. To this end, the responsible Committees of Congress should conduct vigorous oversight, and if need be, consider additional legislation, to assure that:

1. the Government-wide Federal Acquisition Regulation (FAR) and FAR supplements issued by individual departments and agencies faithfully fulfill the letter and spirit of the statutes they are designed to implement;
2. the Administrator of the Office of Federal Procurement Policy (OFPP) undertake a vigorous effort to curtail unwarranted FAR supplements and seek to consolidate such unwarranted departmental coverage in the FAR, to present "one-face" to industry to the maximum extent possible;
3. the newly created Under Secretary of Defense for Acquisition undertake a similar effort to curtail the Military Services and the Defense Agencies from issuing their own supplements to the Defense Department FAR Supplement (DFARS) and that such existing supplements be carefully reviewed for elimination;
4. procuring agencies make greater efforts to forecast their anticipated requirements and publish these estimates so that small business contractors can obtain a "long range view" of the potential market and make an informed business judgment to compete; that procuring agencies collect and publish procurement information by acquisition method codes, including the dollar value as well as the number of items in each category, and acquisition method suffix code;
5. procuring agencies make minimum use of contractor prequalification requirements, conduct such prequalification activities in conformity with legislative requirements, and develop procedures that will permit contractors to become qualified for groups of similar items, so-called "generic qualification" or for those they have indirectly supplied as subcontractors;
6. the Department of Defense sustain its efforts to improve its management of technical data so that prospective competitors may have timely access to complete and current technical data packages suitable for competitive procurements; that government owned technical data be included in bid sets and that GAO study the feasibility of contracting out data management;
7. the Executive departments and agencies acquire technical data,

including proprietary technical data (with fair compensation to the contractor), and special tooling and test equipment to permit competitive acquisition of future requirements, when such items are likely to be needed in substantial quantities to maintain a major system during its expected service life;

8. the Executive departments and agencies, especially the Department of Defense, maintain, and where appropriate expand, their competition advocacy programs;

9. concerted efforts be made to simplify and standardize the regulations, procedures and forms relating to "small purchases" (under \$25,000), which constitute 98% of the Government's procurement activity, especially through the use of automation;

10. the various programs to foster small business participation in the Federal procurement market be fully supported;

11. enact Regulatory Flexibility Act amendment to permit judicial review of agency determinations that a rulemaking effort is not subject to RFA because it has no impact on small business; and

12. the impact of recent procurement legislation enacted without the benefit of hearings is evaluated. Such legislation includes PL 98-94 provisions regarding release of technical data subject to export control as well as provisions of PL 99-661 which raise CRO synopsis threshold to \$25,000, place a time limitation on government right to challenge a contractor assertion of rights in technical data, require negotiation of rights in data for items developed with mixed funding and increase charges for technical data needed to bid. It also includes increased FOIA charges enacted as part of the Anti-Drug Abuse Act of 1986.

Priority Number 17

THE MAINTENANCE OF REASONABLE THIRD CLASS POSTAGE RATES. The Small Business Legislative Council supports the maintenance of reasonable third class postage rates and opposes any attempt to make regular rate mailers subsidize postage for non-profit competitors.

Congress should not compel regular rate mailers to pay higher postage rates to subsidize non-profit organizations. If Congress decides it is in the public interest to maintain reduced postal rates for non-profit organizations, the burden of maintaining those lower rates should be shared by all taxpayers and federal funds should be appropriated to continue the subsidy. If the budget does not continue funding for preferred postage rates, then the non-profit postal rates should be raised to make up the postal revenue shortfall. Congress should take action to prohibit the use of subsidized non-profit postal rates for commercial purposes. Eligibility for non-profit mailing rates should be based on the contents of the mailing and limited to the non-profit purpose of the organization.

Small Businesses need affordable advertising alternatives. For many

businesses, the cost of advertising in the daily newspaper or broadcast media is prohibitive. Direct mail permits small businesses to target their customers, reach consumers in their trade area, and compete effectively with large businesses and franchise stores.

Postage rates for advertising mail are set by the Postal Rate Commission in a rate case proceeding. These proceedings take place when the Postal Service announces that rates must be raised to continue operations. It is likely that a request for a postal rate increase will take place sometime in 1987.

During the last two rate cases, the newspaper industry aggressively requested large increases in third class postage rates. Such an increase would permit newspapers to raise their advertising rates because advertisers would have no competitive advertising alternative. The highest rates would undoubtedly be passed on to small businesses that do not have the bargaining power to negotiate for lower rates or the funds to switch to other media.

The Postal Rate Commission must be made aware of the importance of reasonable postage rates to advertisers and, in particular, small business. The Small Business Legislative Council should be prepared to take an active part in any rate case.

Small Business may be facing an effort in 1987 to increase postage rates to cover part of the costs for subsidized mailings by non-profit organizations. In the past, low subsidized rates for non-profit organizations have been made possible by Congressional appropriations from taxpayer funds. This appropriation is known as the revenue foregone appropriation.

Over the past few years, the volume of non-profit mailings has increased so that the amount of the revenue foregone appropriation has been nearly \$1 billion. Many of the mailings made by non-profit organizations offer goods and services that compete with for-profit businesses that pay full postage rates.

The Administration's fiscal 1988 budget proposal recommends eliminating the revenue foregone subsidy for non-profit mailings but suggests that the low non-profit rates be continued. This could only be done if the Postal Service raised postage rates for regular rate mailers to make up the postal revenue shortfall from the mailings of non-profit organizations.

Any increase in postage rates is a burden for most small businesses. If the government determines it is in the public interest to maintain reduced rates for non-profit organizations, this cost should be shared by all taxpayers. It should not just be passed on to those persons who depend upon the Postal Service.

At the present time, eligibility for subsidized postage rates is based solely on the organization conducting the mailing. Non-profit organizations can promote the sale of goods and services—even when these activities compete with small business—at subsidized rates. A law prohibiting non-profit organizations from using subsidized mail for commercial purposes would reduce the overall cost of subsidized mailings and eliminate unfair competition.

Priority Number 18

POLLUTION LIABILITY INSURANCE. The availability and high cost of pollution liability insurance reached crisis proportions in 1984, and the insurance industry and experts alike hold out little hope for improvement in the future. Like other areas of insurance, the causes of the pollution liability crisis are complex. The liabilities imposed by Superfund, judicial decisions expanding the scope of coverage beyond that which was intended when the policies were written, lack of reinsurance, unwise investment decisions on the part of insurance companies, and ineffective regulation on the state level have all been cited as reasons for the turmoil in the pollution liability insurance market.

While differences of opinion may exist with regard to the cause of the problem, there is little dispute about the serious effect of the unavailability and high cost of pollution liability insurance upon small businesses throughout the United States. Premium increases of between 50 to 200 percent are being reported in certain lines of insurance; and policies are being cancelled and non-renewed at similar rates. Hardest hit are those small firms such as service station owners and operators, garages, fuel oil dealers, dry cleaners and laundries to whom insurance is an essential element of survival because of the nature of the materials they handle or the wastes they produce. The inability to secure pollution liability insurance at affordable rates forces these firms who, unlike large companies, do not have the financial wherewithal to self insure, either to discontinue operations or "go bare". A small firm in the business of handling hazardous materials without the benefit of insurance poses a risk not only to its own financial affairs, but also to the public in general. The inability to obtain adequate liability coverage also severely affects the borrowing power of small businesses. This is an especially critical problem to those firms in need of financing to comply with governmentally mandated environmental protection programs.

In order to address this urgent problem, the SELC urges the following steps.

1. Adoption of a federal reinsurance program under which the government would assume some of the risk undertaken by insurance companies in high-risk lines of liability coverage. Under this plan, the government would have the authority to offer reinsurance to insurers for groups in need of pollution liability coverage.
2. Establishment of an advisory task force to advise the legislative and executive branches of government on solutions to the pollution liability crisis and to assist in the implementation of those measures.
3. Establishment of a temporary federal moratorium on or suspension of any requirements for minimum levels of financial responsibility for affected industries until the crisis abates.

Priority Number 19

IMPROVED COPYRIGHT AND PATENT PROTECTION FOR SMALL BUSINESS. Protection of

intellectual property in the form of patents, trademarks, copyrights, and technical data is critical to the growth of small business. Congress and the Federal agencies should work to protect intellectual property rights of American small businesses at home and abroad by:

1. Implementing a system of equitable fees and accelerated approvals for patents.
2. Accelerating district court handling of patent, trademark and copyright litigation.
3. Collecting data on, and enacting legislation to protect, new US technologies under the intellectual property law system.

Priority Number 20

UNCOMPENSATED OVERTIME. The Federal Government should utilize the 40-hour work week as the basis for competition for contract awards.

Priority Number 20

DRUG FREE WORKPLACE. The use of drugs is an all pervasive problem in our society and all segments of our society must cooperate in an effort to find solutions to the problem.

Small business has an important stake in the outcome which goes beyond the duty of every citizen to make our society drug free. Small business is not immune from the effects of drugs in the workplace. Drug usage effects productivity, it endangers the safety of fellow employees, and it creates an environment for other problems in the workplace. At the same time, small business does not have the resources to develop and implement programs to insure a drug free workplace. Solutions are required which recognize and reflect the needs and conditions of a small business environment.

Additional Issues Not Ranked by Priority

ESTABLISHING A SMALL BUSINESS REGULATORY AGENDA. Legislation such as the Regulatory Flexibility Act, the Equal Access to Justice Act, and the Paperwork Reduction Act now the law of the land, helped create a "healthier" regulatory and policy environment for small business.

A right of judicial review of the Regulatory Flexibility Act should be extended to cover any action of the Federal government which has an impact on small business; the Equal Access to Justice Act should be extended to cover any "adversarial" situation involving the Federal government and small business as parties; and all Federal agencies shall created a senior executive position, reporting directly to the head of the agency, to service as a representative of small business to assure direct access to the policy making process.

It is difficult to anticipate all of the substantive regulatory issues which might have an impact on small business in the next decade. Therefore, to the extent we can create a permanent framework for small business participation in the decision making process we will ensure appropriate consideration on all major policy issues.

We must create an internal structure to ensure an awareness of small business which goes beyond compliance with the mechanics of small business related laws. Agencies are generally not sympathetic to, or fail to fully understand, the particular concerns of small business.

COMPARABLE WORTH. Employers must continually reaffirm their commitment to the goal that all workers, regardless of sex will be treated equally in every phase of employment. However, job duties and responsibilities of employers vary in each small business and do not lend themselves to standardized job description or job evaluation systems based on a standard format. Flexibility and innovation are the bulwarks of small business success. All encompassing, government mandated efforts such as comparable worth stifle small business growth without achieving their objectives. SELC opposes any effort to mandate such programs.

NATIONAL RESTAURANT ASSOCIATIONISSUE POSITION SUMMARIESMinimum Wage

The association has consistently opposed increases in the minimum wage believing they are inflationary, and actually create a barrier for the entry level employee seeking employment. Youth opportunity legislation and changes in the tip credit are integral parts of a minimum wage debate. Efforts should be made to expand the tip credit allowance (currently 40% of the federal minimum wage), or at the very least, to prevent further erosion.

Indexing the minimum wage by tying it to the average manufacturing wage, or any other factor, should be prevented. Indexing simply feeds upon itself --- each increase of one indicator requiring an increase of the other.

Polygraph Usage

The association opposes an absolute ban on polygraph use. Alternative legislation to allow private sector polygraphs, subject to certain standards, is a possible compromise.

Occupational Hazard Notification

The association will seek to ensure that the foodservice industry is exempted from coverage under this legislation by Standard Industrial Classification code.

Plant Closings/Worker Dislocation

The association will seek to establish that:

- Service industry is exempted
- Part-time employees are excluded for employee threshold purposes
- Employee threshold is adjusted upward
- Advance notice not be mandatory
- Funding mechanism for retraining program is not employer-paid payroll tax

CONCERNED ALLIANCE OF RESPONSIBLE EMPLOYERS

"IF IT AIN'T BROKE, DON'T FIX IT..."

WE URGE CONGRESS TO PROTECT THE VOLUNTARY BENEFIT SYSTEM CURRENTLY ENJOYED BY EMPLOYERS AND EMPLOYEES. Currently there are only three government-required entitlements -- Social Security, worker's compensation, unemployment insurance. It did not take an act of Congress for employers to provide a vast array of employee benefits:

- health insurance, including dependent coverage
- dental and vision care
- long and short-term disability coverage
- life insurance
- vacation and sick leave
- maternity leave
- pension and retirement coverage
- holidays
- bereavement leave
- education assistance
- legal assistance
- adoption assistance
- profit sharing
- employee assistance programs
- employee discounts

DICTATING ANY ONE PARTICULAR BENEFIT LIMITS THE ABILITY OF EMPLOYERS TO OFFER BENEFITS THAT MAY BE MORE APPROPRIATE FOR THEIR WORKFORCE. Financial assistance for child care is just one example of a benefit that may be more desired by working parents.

ACROSS-THE-BOARD MANDATES ARE BASED ON ERRONEOUS ASSUMPTIONS. In fact:

- All businesses are not alike.
- Economic and business climates are not stable.
- All employee needs are not the same.
- The costs of mandated parental leaves will limit the availability of other benefits.

CONGRESS IS ATTEMPTING TO MICRO-MANAGE THE NATION'S BUSINESSES, WHILE REFUSING TO ACCEPT THE BURDEN ITSELF.

THE MOST IMPORTANT EMPLOYEE BENEFIT IS A PAYCHECK. Indiscriminate across-the-board mandates threatens the viability of firms and the jobs they provide.

FICA ON TIPS FACT SHEET

National Restaurant Association Position - Opposed to the provision within the Administration's FY 1988 budget plan which requires employers to pay Social Security taxes on declared tips in excess of the tip credit.

Reasons for Opposition

1. Social Security is a payroll tax based upon wages (and any tip credit) paid by the employer. Since tips are not wages paid by the employer but monies received by the waiter/waitress, the employer should not be responsible for paying FICA on tips. The Administration's proposal, in effect, is treating gratuities paid by the customer as if they were wages paid by the employer.
2. Tipping is a transaction between a restaurant patron and an employee. Management has no involvement in or control over this transaction. Requiring the restaurant operator to pay Social Security tax on unpredictable tip income reported by employees would create problems in planning and budgeting.
3. Tipped employees already make Social Security contributions on their tips and are entitled to collect full benefits on their total income at retirement.
4. The proposal's effect on an employer's FICA tax liability would be significant. Currently, an employer makes FICA payments on up to the minimum wage for tipped employees; for a tipped employee receiving \$3.35 per hour, an employer pays \$.24 per hour in FICA taxes. The following example illustrates the impact that the Administration's proposal could have on employers: For a tipped employee whose cash wages and reported tips totaled \$5.71 per hour, the employer's share of FICA under the new proposal would rise to \$.41 per hour, a 71 percent increase. (Note: the employer's share may increase by more or less, based on the amount of cash wages and reported tips.)
5. This proposal was raised once before during debates on the Social Security Amendments of 1965. At that time it was rejected by Congress, which stated, "Tips are not considered as remuneration for employment for purposes of the employer taxes imposed by Section 3111 of the code." There is no rationale or new information to justify reversing this judgment in 1987.
6. President Reagan pledged no increase in taxes. Yet, applying employer-paid Social Security tax on tips amounts to a \$200 million (Administration estimate) tax increase for restaurateurs during the first year. In the January 9, 1987 Wall Street Journal, Treasury Secretary James Baker acknowledged that FICA on tips could also be considered a tax increase.
7. This tax increase will be borne by small, independent restaurant operators who employ the vast majority of waiters and waitresses. These restaurateurs are least able to absorb this new tax burden.
8. Although sizeable to the restaurant industry, the \$200 million generated from FICA on tips would be considered a relatively small amount of revenue for the financially sound Social Security Trust Fund. Any revenue raised would be dedicated to the Trust Fund and could not be spent for other federal programs. Therefore, FICA on tips would have no real effect in reducing the federal deficit.

Summary Statement

FICA on tips is a tax increase which: (1) hurts the employer; (2) is of no benefit to the employee; and, (3) does not reduce the federal deficit.

1/28/87

February 5, 1987

Dear :

As the 100th Congress begins, your office will receive a number of "Dear Colleague" letters urging your cosponsorship of a variety of bills dealing with employee-employer relations.

The National Restaurant Association, and the 125,000 foodservice operations it represents, respectfully urges you to proceed cautiously before cosponsoring such legislation.

Parental and disability leave, COBRA, mandated health benefits health risk pooling, catastrophic health insurance coverage, plant closings, and other so-called "no expense to the taxpayers" proposals are being offered.

We all know there is no such thing as a free lunch. Someone must pay for these programs. It is no accident that over 11 million jobs have been created in the last six years in the United States, while the so-called "enlightened" industrial nations have no new net employment in the same period.

The overwhelming majority of our members are small, independent business-people. All of these wonderful sounding, "no expense to the taxpayers" proposals have one thing in common: the method of payment requires increased payroll taxes or increased payroll costs.

Please carefully evaluate the cost in dollars and jobs before signing on to bills that sound like motherhood and apple pie.

My office and our members from your district will be following up with a request to speak to you and your staff concerning these issues at your convenience. In the meantime, please give your constituent employers a chance to be heard before determining your position.

Sincerely,

Ronald A. Sarasin
Director, Government Relations



/From the New York Times/

The New York Times

Founded in 1851

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The Right Minimum Wage: \$0.00

The Federal minimum wage has been frozen at \$3.35 an hour for six years. In some states, it now compares unfavorably even with welfare benefits available without working. It's no wonder then that Edward Kennedy, the new chairman of the Senate Labor Committee, is being pressed by organized labor to battle for an increase.

No wonder, but still a mistake. Anyone working in America surely deserves a better living standard than can be managed on \$3.35 an hour. But there's a virtual consensus among economists that the minimum wage is an idea whose time has passed. Raising the minimum wage by a substantial amount would price working poor people out of the job market. A far better way to help them would be to subsidize their wages or — better yet — help them acquire the skills needed to earn more on their own.

An increase in the minimum wage to, say, \$4.35 would restore the purchasing power of bottom-tier wages. It would also permit a minimum-wage breadwinner to earn almost enough to keep a family of three above the official poverty line. There are catches, however. It would increase employers' incentives to evade the law, expanding the underground economy. More important, it would increase unemployment: Raise the legal minimum price of labor above the productivity of the least skilled workers and fewer will be hired.

If a higher minimum means fewer jobs, why does it remain on the agenda of some liberals? A higher minimum would undoubtedly raise the living standard of the majority of low-wage workers who could keep their jobs. That gain, it is argued, would justify the sacrifice of the minority who became

unemployable. The argument isn't convincing. Those at greatest risk from a higher minimum would be young, poor workers, who already face formidable barriers to getting and keeping jobs. Indeed, President Reagan has proposed a lower minimum wage just to improve their chances of finding work.

Perhaps the mistake here is to accept the limited terms of the debate. The working poor obviously deserve a better shake. But it should not surpass our ingenuity or generosity to help some of them without hurting others. Here are two means toward that end:

□ *Wage supplements.* Government might subsidize low wages with cash or payments for medical insurance, pensions or Social Security taxes. Alternatively, Washington could enlarge the existing earned income tax credit, a "negative" income tax paying up to \$800 a year to working poor families. This would permit better targeting, since minimum-wage workers in affluent families would not be eligible.

□ *Training and education.* The alternative to supplementing income for the least skilled workers is to raise their earning power in a free labor market. In the last two decades, dozens of programs to do that have produced mixed results at a very high cost. But the concept isn't necessarily at fault; nurturing the potential of individuals raised in poverty is very difficult. A humane society would learn from its mistakes and keep trying.

The idea of using a minimum wage to overcome poverty is old, honorable — and fundamentally flawed. It's time to put this hoary debate behind us, and find a better way to improve the lives of people who work very hard for very little.

THE COST OF MANDATED BENEFITS

Mr. QUAYLE. Mr. President, on Thursday, February 5, 1987, the Washington Post published an editorial on a proposal by Senator KENNEDY which would mandate that all employers provide health insurance to their workers, and dependents, as a condition of employment. The Post supported the proposal, recognizing that the added cost to the employer will inevitably mean higher prices passed on to consumers. Perhaps more importantly, the Post has recognized that if employers are forced to spend more money on mandated benefits, then there will be less money to spend on job creation in times of plenty, or job preservation in times of financial constraint.

Congress seems to have an insatiable desire to create new social programs and subprograms. However, the current high budget deficit has deterred some in the 100th Congress from proposing expensive new programs to provide group-specific benefits for workers. Instead, Congress is turning to its other source of revenue—employers—and proposing that they pay for new benefits to workers and their families.

By definition, these mandates benefit workers, whether they are higher minimum wages, minimum or catastrophic health insurance, medical monitoring of at-risk employees, return

tion of health and other benefits during maternity and family leave and increases in pension plan costs, all of which have been proposed. As the Post editorial pointed out, these benefits are not free. They cost money—and they cost jobs. The benefits for employed workers are paid for by those who cannot get jobs because of the resulting higher labor costs.

All economists will agree that increased labor costs have some adverse impact on employment, though there is much difference of opinion among experts about the extent and nature of that impact. Our economy has created 12.4 million jobs in the last 4 years; most of them in small businesses. In fact, last year, nearly 750,000 new businesses were started in the United States, about 6 a minute for every working day—some 14,000 per week. These are not all Fortune 500 corporations. Many are small businesses, started by ordinary people who sacrifice their personal savings for their business. These job-creating businesses are particularly sensitive to increases in labor costs. If Congress mandates an increase in costs to employers, then we must be certain that this job-generating machine is not suffocated in the process.

I have proposed that Congress consider the potential disemployment effect of each mandated benefit before

February 19, 1987

CONGRESSIONAL RECORD — SENATE

S 2321

it can be passed into law. My proposal is not intended to prejudice the merit of any bill. Instead, it is intended to require that we consider the employment impact of proposed increases in labor costs in their totality, before we act on individual bills.

When we pass legislation to help workers we must be careful that we will not take away from employers the means to provide jobs. Jobs are the reason why the world's poor still flock to this Nation. Jobs are the critical underpinning of the economy, and the reason for our current high standard of living.

If we fail to take employment costs and employment impact into consideration when we pass legislation, we do a disservice to the American people. We must find a way to balance providing a special benefit to new mothers, industrial workers, or minimum wage employees, with potential layoffs and unemployment impact these added costs will have to the businesses that provide jobs.

I will offer my proposal to the rules of the Labor and Human Resources Committee at its upcoming meeting on February 25, 1987. I hope for strong bipartisan support for this affirmation of the Congress' promise that we cannot and will not wantonly mandate benefits on employers, without having limited their impact on direct employer costs.

I have attached a copy of the letter I sent to Senator Kennedy, a similar copy of which was sent to all members of the committee. In addition, I have a copy of the editorial that appeared in the Washington Post on February 5, 1987. Finally, I have a copy of a recent article which appeared in the Congress-

sional Quarterly on the subject of benefit mandates.

Mr. President, I ask that these documents be printed in the Record.

The material follows:

U.S. SENATE

Washington, DC, February 5, 1987.

Hon. EDWARD M. KENNEDY,
Chairman, Committee on Labor and
Human Resources, U.S. Senate, Wash-
ington, DC.

DEAR SENATOR KENNEDY: At our organizational meeting on February 25, 1987 I plan to offer an amendment to the Committee's rules to ensure that we consider the potential employment effects of mandated benefits programs. The text of the proposed rule is enclosed as Attachment I.

During this Congress, the Committee will consider many proposals that would increase employer costs, such as minimum wage increases, mandated health benefits, increase in PBGC premium rates, medical monitoring of at risk employees, retention of benefits during maternity leave, etc. We all know that increased labor costs have some adverse impact on employment though there is much difference among economists about the extent and nature of that impact.

Our economy has created 12.4 million jobs in the last 4 years; most of them in small business, which are particularly at risk from increased labor costs. We must be sure that we do not inadvertently suffocate this job generation process.

My amendment is not intended to prejudice the merits of any bill. Instead, it is designed to require that we consider the employment impact of proposed increases in labor costs in their totality before we act on individual bills. Attachment II is a table showing average wages by industry and size of employer. It shows that an additional \$3.00 a week cost (a modest estimate for current proposals) would be equal to just under 10 percent of wages in manufacturing establishments with under 5 employees and to 10 percent to 13 percent in large retail oper-

ations. The amendment would require us to decide whether the unemployment effects of such an increase are worth the social benefit to be achieved. Attachment III gives the same information for Massachusetts.

In support of my amendment, I would suggest the analogy of the Budget Act under which we consider the total amount the Federal government can spend before we decide on the amounts for each program. Under my amendment, the Committee will have to consider the total amount that we think it appropriate to require employers to spend before we impose specific cost items on them. Before deciding that total amount, we will have to consider whether the benefits of these amounts will outweigh the potential unemployment effects. We remain free to make any decision—but we are required to evaluate the effects of the decisions that we do make.

I am confident that you will give this important matter your very serious consideration. If we neglect to take the employment costs into consideration, we will do a great disservice to the American public.

Sincerely,

DAW QUAYLE,
U.S. Senator.

P.S.—The wage data is unpublished, preliminary material from the BLS.

ATTACHMENT I
TEXT OF RULE

The rules of the Senate Committee on Labor and Human Resources are amended by adding at the end thereof the following: "Rule 21. It shall not be in order to report any bill having a substantial effect on employer labor costs until the Committee adopts a resolution specifying the maximum increase in such costs that will not adversely affect employment opportunities. Any bill reported after the adoption of such resolution shall not, in combination with all other bills reported previously during the 100th Congress, increase employer labor costs in excess of the amount provided in such resolution."

ATTACHMENT II

MAJOR 1986 EMPLOYMENT AND AVERAGE WEEKLY WAGES BY SIZE OF REPORTING UNIT, PRIVATE INDUSTRY, UNITED STATES, FIRST QUARTER 1986

(United States (excluding Puerto Rico and Virgin Islands))

Private industry	Total	Size of reporting unit								
		1 to 4 workers	5 to 9 workers	10 to 19 workers	20 to 49 workers	50 to 99 workers	100 to 249 workers	250 to 499 workers	500 to 999 workers	1,000 workers or more
All industries	80,278,955	5,191,701	6,254,228	7,874,120	11,945,454	9,808,926	12,482,357	1,785,206	6,455,130	12,315,922
Average weekly wages	\$362	\$324	\$275	\$228	\$237	\$244	\$258	\$286	\$429	\$245
Agriculture, forestry, and fishing	1,066,622	114,321	148,636	123,794	294,122	134,551	144,275	81,941	45,344	18,958
Average weekly wages	\$227	\$206	\$231	\$214	\$213	\$219	\$213	\$234	\$242	\$225
Manufacturing	831,875	82,958	43,733	16,754	134,944	109,483	132,146	97,545	98,499	109,954
Average weekly wages	\$427	\$454	\$463	\$477	\$527	\$510	\$544	\$577	\$538	\$521
Construction	4,487,691	519,149	436,541	759,119	970,043	611,182	493,773	384,523	220,718	128,143
Average weekly wages	\$412	\$381	\$240	\$213	\$471	\$462	\$364	\$314	\$372	\$296
Transportation, communications, and public utilities	18,529,954	215,576	411,287	782,117	1,750,544	1,957,873	2,438,770	2,769,521	2,435,431	5,172,195
Average weekly wages	\$477	\$217	\$215	\$215	\$215	\$215	\$215	\$215	\$215	\$215
Trade, hotels, restaurants, and recreation	4,853,719	184,184	242,681	371,442	641,552	546,713	685,752	448,944	425,713	1,764,130
Average weekly wages	\$312	\$289	\$287	\$287	\$429	\$444	\$444	\$444	\$444	\$444
Government	5,689,033	481,041	637,537	954,057	1,222,117	848,751	757,641	345,166	181,057	189,771
Average weekly wages	\$477	\$467	\$434	\$434	\$434	\$434	\$434	\$434	\$434	\$434
Services	17,318,474	1,137,621	1,725,774	2,194,216	3,287,413	3,532,198	2,183,179	1,277,744	682,471	2,895,114
Average weekly wages	\$209	\$148	\$126	\$192	\$200	\$214	\$214	\$214	\$214	\$214
Health, education, and social services	6,095,426	485,671	427,456	499,116	831,444	728,033	911,782	577,089	488,896	1,287,517
Average weekly wages	\$210	\$214	\$213	\$213	\$213	\$213	\$213	\$213	\$213	\$213
Unemployed	20,985,185	1,971,852	1,984,975	2,378,191	2,647,702	2,107,849	2,220,059	1,583,476	1,694,416	3,164,172
Average weekly wages	\$290	\$410	\$410	\$410	\$410	\$410	\$410	\$410	\$410	\$410

Prepared by U.S. Bureau of Labor Statistics, Office of Employment and Unemployment Statistics, Division of Occupational and Administrative Statistics.

ATTACHMENT III

MARCH 1986 EMPLOYMENT AND AVERAGE WEEKLY WAGES BY SIZE OF REPORTING UNIT, PRIVATE INDUSTRY, UNITED STATES, FIRST QUARTER 1986

Private industry	Total	Size of reporting unit								
		1 to 3 workers	4 to 9 workers	10 to 19 workers	20 to 49 workers	50 to 99 workers	100 to 249 workers	250 to 499 workers	500 to 999 workers	1,000 workers or more
All industries										
Manufacturing	2,495,993	127,800	170,354	221,561	346,439	311,927	425,198	243,177	210,473	438,664
Average weekly wages	\$790	\$319	\$347	\$343	\$346	\$351	\$359	\$401	\$428	\$512
Agriculture, forestry and fisheries	14,542	2,092	3,786	3,943	2,343	1,271	892	NO	NO	NO
Average weekly wages	\$319	\$247	\$307	\$320	\$291	\$283	\$336	NO	NO	NO
Nonmanufacturing	1,487	87	210	196	319	524	NO	NO	NO	NO
Average weekly wages	\$459	\$361	\$407	\$390	\$425	\$510	NO	NO	NO	NO
Construction	104,334	15,662	15,175	21,352	22,607	13,745	7,492	3,708	NO	NO
Average weekly wages	\$491	\$240	\$276	\$418	\$476	\$589	\$664	\$584	NO	NO
Transportation, communication, and public utilities	627,414	5,593	11,527	23,334	58,177	85,484	111,899	81,353	75,144	189,948
Average weekly wages	\$482	\$246	\$258	\$401	\$402	\$408	\$428	\$451	\$430	\$593
Wholesale and retail trade	121,180	4,317	5,757	8,431	16,320	16,958	22,307	17,958	10,647	18,580
Average weekly wages	\$448	\$247	\$251	\$362	\$387	\$421	\$493	\$463	\$364	\$639
Services	155,500	11,655	15,118	23,384	34,897	26,757	24,680	8,761	8,067	NO
Average weekly wages	\$511	\$537	\$497	\$483	\$487	\$501	\$545	\$508	\$586	NO
Total	525,273	77,427	48,583	68,104	108,487	88,430	97,337	40,807	26,385	18,917
Average weekly wages	\$210	\$209	\$196	\$230	\$217	\$254	\$195	\$215	\$254	\$327
Finance, insurance, and real estate	193,355	10,769	11,689	13,480	20,588	20,578	37,160	18,630	15,062	56,999
Average weekly wages	\$519	\$420	\$457	\$493	\$503	\$527	\$541	\$563	\$527	\$538
Government	217,628	50,767	54,608	59,027	82,791	78,219	107,834	71,155	74,588	158,219
Average weekly wages	\$358	\$249	\$219	\$266	\$250	\$270	\$285	\$238	\$219	\$468

Prepared by U.S. Bureau of Labor Statistics, Office of Employment and Unemployment Statistics, Division of Occupational and Administrative Statistics.

[From the Washington Post, Feb. 5, 1987]

HEALTH INSURANCE FOR ALL WORKERS

Sen. Edward Kennedy says he will introduce a bill to require all employers to offer health insurance to all their employees. The proposal by the new chairman of the Senate Labor and Human Resources Committee is part of a trend. The budget is too crowded to create new federal programs of the usual kind. Those who want to offer new benefits have taken to mandating them instead, by requiring the states or employers to provide them. They are able to produce the results they want without the explicit federal costs. Thus Congress required two years ago that employers providing health insurance give laid-off employees the right to continue buying it for a limited period after they leave. Last year Congress also nearly required the states to set up risk pools through which those without health insurance could buy it. The pools would have been financed in part by a tax on employers.

In times past, the business community would have been nearly unanimous in opposing such initiatives. Now it is split. Many larger companies particularly—those that already provide such benefits—think it only fair that all should bear a proportionate cost.

The cost-shifting instinct is not confined to health insurance. The House Education and Labor Committee approved legislation last year to require most employers to grant unpaid leave to parents of newborns and to workers either sick themselves or who need time off to care for sick family members. Congress in recent years has also greatly increased the requirements that must be met before a pension contribution can be tax deductible.

Mr. Kennedy and others note that their approach is not new. There have been minimum-wage and maximum-hours laws for years, as well as requirements that employers provide unemployment and injury insurance. A requirement that they also provide some minimal amount of health insurance would simply extend this pattern.

The government has also traditionally transferred costs to the private sector in

other fields. The sugar price-support system operates almost entirely outside the budget; the subsidy is paid at the grocery store in the form of higher prices ensured through import quotas. Environmental laws also require companies to bear certain clean-up costs, which they ultimately pass on.

There is nothing inherently wrong with this approach of salting the private sector with public goals. By moving programs outside the budget, the practice blurs the traditional public-private distinction around which too much political debate revolves. But in also blurring costs, it does more disservice than good. It may well be that Congress should require all employers to provide health insurance. But the benefit to employees will be a cost to employers and consumers. A transfer would occur as surely as if there were a formal government transfer payment. As the economist never tire of telling us, there is no free trip to the doctor's office.

CONGRESS AIMS AT MINIMUM BENEFIT PACKAGE
(By Julie Rovner)

Over heated objections from the business community and warnings of dire economic consequences, the Democratic-led 100th Congress is moving on a number of fronts to force employers to provide workers with a minimum package of benefits.

Congress actually took a first step toward mandated benefits when it passed the fiscal 1986 budget reconciliation bill (PL 99-272). That measure required employers to offer continued health insurance coverage to laid-off workers, as well as spouses or dependents of workers who would otherwise lose coverage as a result of death or divorce.

Proposals being offered in the 100th Congress include a requirement that employers who offer health insurance coverage also offer protection against catastrophic health care costs. Failure to do so would cost the company its insurance tax deduction.

Sen. Edward M. Kennedy, D-Mass., proposes taking that one step further. He told the American Hospital Association Feb. 2 that "the time has come to require all busi-

nesses in America to offer health insurance to all their workers . . . as a condition of doing business."

But the first big fight in the battle to expand mandated benefits is likely to come over legislation guaranteeing job-protected leave for disabled workers, new parents and those who need to care for a seriously ill dependent.

FAMILY AND MEDICAL LEAVE BILLS

The House version of the leave legislation (HR 925) is sponsored by William L. Clay, D-Mo., and Patricia Schroeder, D-Colo., while the Senate version (S 249) is sponsored by Christopher J. Dodd, D-Conn.

Both bills would require employers to offer unpaid, job-protected leaves of up to 18 weeks to new parents and those needed at home to care for a seriously ill child, and leaves of up to 26 weeks for workers with temporary disabilities. The House bill would also permit workers to take up to 18 weeks of leave to care for a dependent parent who is ill.

The legislation would require that businesses with 15 or more employees offer the leaves, that health insurance be continued during the leave and that after the leave, workers be returned to their old or a comparable job with full seniority.

Sponsors described the legislation as a pro-family measure designed to ensure job protection during times of great family stress. "If the family is straining because nobody is left at home to care for the newborn or seriously ill child or parent, then a labor standard that can substantially relieve that stress is good and necessary public policy," said Clay.

The bills are similar to legislation (HR 4300) approved by the House Post Office and Education and Labor committees in 1986, but never considered by the full House.

This year the legislation is on "a fast track," said Clay, chairman of the subcommittee with partial jurisdiction over the bill. At a Feb. 3 news conference, Clay pledged to bring the legislation to the floor by April.

Sponsors said their effort got a boost from two recent Supreme Court decisions: one finding that federal law does not bar states from enacting laws to give special protection to women who leave their jobs to have children and another finding that federal law also does not require that new mothers be given special consideration.

FORMIDABLE OPPOSITION

Working against the bill, however, is much of the business community, led by the U.S. Chamber of Commerce. The Chamber said costs of the legislation would be prohibitive for many companies and would make it harder for the United States to compete in world markets.

The Chamber estimated it would cost the average employer in Washington, D.C., more than \$5,000 to cover the costs of an 18-week leave taken by a word processor and said sponsors "ignore the anti-competitive impact of this costly new proposal on American businesses."

But the bill's proponents disagreed. "No study I've seen indicates there will be any great additional cost," said Dodd. In fact, he said, just the opposite is true. "Companies who have already instituted parental leave policies find they are better able to attract workers and increase their productivity and at the same time decrease employee absenteeism and turnover."

Sponsors also denied that the measure would put U.S. businesses at a disadvantage in terms of international trade. "Japan already is (providing job-protected leave) and they were fairly competitive the last time I looked," said Schroeder. "The countries we're most concerned about competing with already do this."

COMPROMISE OFFERED

Hoping to bridge some of the differences between the two sides is Rep. Narge Roukema, R-N.J., an Education and Labor Committee member who has introduced her own version of family leave legislation (HR 284).

Roukema's bill would allow only eight weeks of family leave and 13 weeks of disability leave, and would exempt businesses with less than 50 employees. "I think there's a growing recognition that something is necessary, but something that does not cripple small businesses," she said.

But even Roukema admits that so far her bill has little support from either side. Those supporting Schroeder and Clay argue that the 50-worker exemption would deny leaves to more than 40 percent of the work force.

And Don Berno, small-business lobbyist for the Chamber of Commerce, said his group did not like the Roukema bill either. "Compromise is not in our vocabulary when it comes to this bill," he said. "This is purely a question of philosophy to us." ■

Statement of the NATIONAL ASSOCIATION OF HOME BUILDERS before the

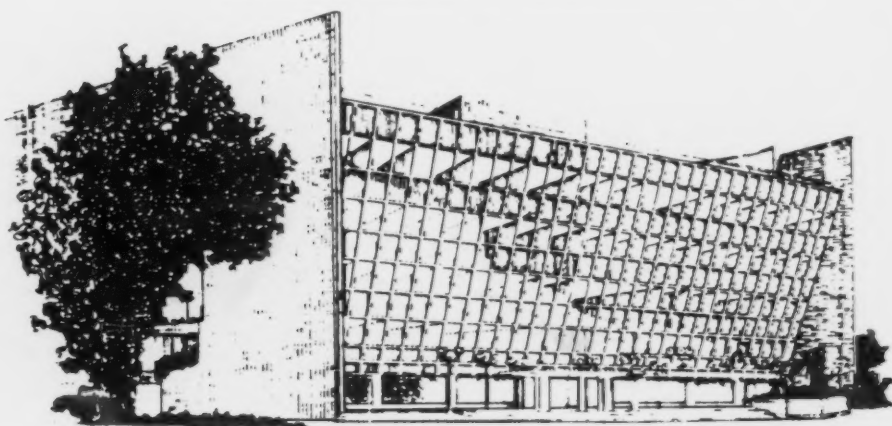
Committee: Senate Small Business

Subject: Forum on Legislative
Priorities

Witness: James H. Schuyler, Staff Vice
President/Legislative Counsel

Date: February 25, 1987

Place: Washington, D.C.



National Housing Center
15th and M Streets, N.W.
Washington, D.C. 20005
(202) 822-0470

○ Housing Bill

NAHB supports a housing bill which continues responsible levels of support for urban and rural housing and community development programs. We support long-term or permanent extension of the basic FHA insurance programs, which were shut down over 50 days last year because of lapses in authority. We support language prohibiting any new so-called "user fees" on mortgage credit or secondary market programs. We strongly support continuation of FHA insurance for investor loans, which provides needed rental housing and helps builders control their inventories. We urge Congress and the Administration to maintain the requirement that "manufactured" or mobile homes be built on a permanent chassis in order to be eligible for their HUD building code. If the chassis is removed, the house should meet all state and local building codes, including higher energy standards and structural standards, required for conventionally built housing. Finally, we urge Congress to examine closely the problem of existing low- and moderate-income housing built under federal programs to provide incentives to maintain this housing for lower-income families and the elderly when existing contracts expire.

○ Other Issues

NAHB is concerned about legislation in a broad variety of areas, including labor, energy, environment, financial institutions, and general business issues. We will keep you informed on a regular basis regarding issues of interest to the homebuilding industry, homebuyers and renters.

○ National Housing Policy

Although housing continues to be a high priority of the American people, the ranking of housing as a national priority has been downgraded in recent years. Young families face increasing obstacles to affordable homeownership, as evidenced in the decline in the homeownership rate since 1980. Debate in recent years has centered on the proper government role in housing and mortgage finance.

NAHB believes that there is a need for the development of a comprehensive national housing policy. We emphasize that the private sector can meet the housing needs of most Americans. But all levels of government must be involved in assuring decent housing and homeownership opportunities for our citizens. NAHB has developed a "Blueprint for National Housing Policy" which identifies the goals and principles which lead to development of specific policy recommendations. We seek to work with Congress to begin the debate and help shape national housing policy for the years ahead.

NATIONAL ASSOCIATION OF HOME BUILDERS1987 KEY LEGISLATIVE ISSUES○ Federal Budget Deficit

NAHB continues to be concerned about the size of the federal deficit and has long supported across-the-board reductions in federal spending. We support responsibly meeting the Gramm-Rudman-Hollings deficit targets, through a combination of reductions in domestic spending, defense and entitlement programs. Housing programs have suffered disproportionate cuts since 1980 -- a 70 percent reduction in budget authority for the Department of Housing and Urban Development. Therefore, we believe that funding levels for housing assistance programs should be maintained at or near their current levels.

○ Mortgage Credit Programs

Proposed restrictions or increased fees on government-sponsored mortgage credit programs have been mistakenly presented as "deficit reduction." The FHA mortgage insurance program, which has served millions of young families and homebuyers of modest incomes over the past 50 years, does not cost the federal government any money -- in fact, the basic insurance program operates at a profit. The VA loan guaranty program is an entitlement for those who have ably served in the armed forces. The secondary market agencies -- Fannie Mae, Ginnie Mae and Freddie Mac -- are essential to provide homebuyers access to affordable credit in the broader capital markets. We oppose any restrictions on access to these programs or so-called "user fees" which would raise costs to the homebuyer or reduce the effectiveness of these vital self-supporting programs.

○ Tax Legislation

We believe that the federal tax code represents an essential element of our national policy to promote homeownership and affordable rental housing. We will monitor closely the effects of tax reform, particularly on the construction, rehabilitation, and maintenance of rental housing. Rental housing was particularly hard hit by the recent tax law changes. We will recommend and support modest technical and corrective changes in the tax laws where needed.



Legislative Solutions
to the
Payment Problems of Subcontractors
on Federal Construction

Statement of
AMERICAN SUBCONTRACTORS ASSOCIATION

to the
COMMITTEE ON SMALL BUSINESS
UNITED STATES SENATE

February 25, 1987

AMERICAN SUBCONTRACTORS ASSOCIATION, INC.
1004 DUKE STREET, ALEXANDRIA, VA 22314-3512
(703) 684-3450



Legislative Solutions to the
Payment Problems of Subcontractors on Federal Construction

My name is Mac Sullivan. I am executive vice president of Sullivan Mechanical Contractors, a family-owned company in Shenandoah, Virginia.

Today, I am representing the American Subcontractors Association.

ASA is a national trade association with more than 6,500 firms representing all major construction trades in 55 chapters. In addition to its individual company members, ASA represents 15 other specialty trade associations with members of their own.

Two years ago during a similar hearing before this Committee, ASA testified that the most important issue facing construction subcontractors was getting paid for work performed. Every survey, meeting, and discussion shows that this remains true.

Subcontractors depend on the cash flow generated by payments on account to meet their payrolls and loan payments and to pay their suppliers. Yet some prime contractors take 90, 120, or more days to pay their bills.

For a big business, such a delay in payment would undoubtedly cause some consternation in the bookkeeping department, but business would go on as usual. For a small firm,

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the size of most construction subcontractors, however, one payment might mean the difference between survival and disaster.

I would like to thank the members of the Small Business Committee for their leadership and support in seeking solutions to the payment problems of construction subcontractors. Every member of this Committee is a cosponsor of S.328, the Prompt Payment Act Amendments of 1987, which was introduced by Senator Sasser with the support of Senator Tribble and a majority of the members of the Senate.

Section 7 of S.328 recognizes that a payment clause is a critical and necessary component of a complete subcontract and requires a prime contractor on a federal construction project to include a payment clause in the contracts which it negotiates with its various subcontractors. That payment provision must conform with "prevailing industry standards".

Section 7 also provides an enforcement mechanism under which the agreement between a prime contractor and a subcontractor must entitle the subcontractor to a late payment interest penalty at the same rate applicable between the prime contractor and the government if the prime contractor fails to make payment in accordance with the subcontract's payment clause.

Apparently there are some misunderstandings about just what section 7 of S.328 would do and what its impact would be on the federal procurement system. Senator Sasser's introductory statement on the bill contains a detailed analysis of the

subcontractor payment provision. In addition, the written statement accompanying this testimony contains a more detailed discussion of this issue.

ASA and its members believe that Section 7 of S.328 would end late pay to subcontractors from prime contractors who routinely pay late in order to gain a competitive edge or to increase their profits. It does not address a situation where a prime contractor cannot pay its subcontractors because of financial or other problems.

Congress recognized this issue when it enacted the Miller Act in 1935. The Miller Act provides for a performance bond for the protection of the government and a payment bond for the protection of the subcontractor or supplier on a federal construction project. At the time of enactment and later amendment, the Miller Act was considered to be a good law and, up to a point, it has been.

But the protection afforded by the Miller Act, as it stands today, is a snare and a delusion. Any subcontractor who has had experience with a suit on a Miller Act bond, will resort to it only when the prime contractor is hopelessly insolvent.

ASA believes that the Miller Act must be amended in several areas if it is to once again live up to the expectations of Congress--and more importantly, to protect the subcontractor and supplier on federal construction projects.

First, ASA proposes that the Miller Act be amended to eliminate alternative securities to corporate bonds and to permit only bonds issued by surety companies approved by the U.S. Treasury Department.

Treasury already is required to approve the surety companies that issue bonds on federal projects. However, the regulations implementing the Miller Act also allow a contractor to post other types of securities in lieu of a corporate bond. These alternatives include certified or cashier's checks, bank drafts, money orders, U.S. bonds or notes, and even individual sureties.

The standards for such alternatives nowhere meet the strict standards for corporate sureties. A contractor who posts such an alternative to a corporate surety bond may not have been "prequalified" by an experienced agent and the liquidity of the "security" is not assured. In addition, the administration of such alternative securities is burdensome for the responsible government agency.

When alternative securities to corporate bonds are used on federal construction, subcontractors are at a greater risk since the government's first priority is assuring completion of the project--not payment of subcontractors who may have performed prior to the general contractor's default.

ASA also recommends that the Miller Act be amended to provide that the payment bond be at least equal to the performance bond.

Under the Miller Act, the government is protected by a performance bond in an amount the contracting officer "deems adequate for the protection of the United States." That amount is usually 100%.

Subcontractors, however, are protected by a payment bond which is only one-half of the contract amount if the contract is less than \$1 million; 40% of the contract amount if the contract is between \$1 million and \$5 million; and a \$2.5 million maximum if the contract is for more than \$5 million. The maximum dollar protection for a subcontractor under the Miller Act has been severely eroded by inflation. In any event, ASA believes that subcontractors deserve the same protection as the government is now granted under the Act.

ASA further recommends that the Miller Act be amended to place an affirmative obligation on the government to assure prime contractor compliance with the Miller Act.

In the event that a Miller Act bond is not posted by the prime contractor, the contract is voidable and can be terminated by the government at its option. If the government does not terminate the contract, and the contractor defaults, the subcontractor claimant has no recourse to collect the money it is owed.

ASA believes it is wrong--and an abrogation of congressional intent--for a subcontractor to suffer a financial loss because of the government's failure to enforce the Miller Act.

In addition, ASA recommends that the Miller Act be amended to nullify any contract provision that would directly or indirectly waive a subcontractor's rights under the Miller Act.

Some agreements between a prime contractor and subcontractor require the subcontractor to waive these rights. Such subcontract provisions often are designed to protect the prime contractor and his surety by providing them with defenses on a bonded job. Given the uneven negotiating power between a prime contractor and subcontractor, ASA believes that such provisions--which operate to the legal and practical detriment of the subcontractor--should be against public policy.

ASA's other recommended amendments to the Miller Act are designed to prevent technical defenses to otherwise recoverable Miller Act suits.

ASA recommends that the Miller Act be amended to allow notices to be sent by certified or other system of mail by which receipt can be proven. The Miller Act requires that notice be given by "registered mail". Although most courts have excused this requirement when it is shown that a prime contractor actually received notice, it still may provide the surety with a technical defense to an otherwise recoverable Miller Act suit.

The Miller Act requires a claimant to file suit after 90 days but within one year from his last day of furnishing labor or material on a project. ASA proposes two modifications to this "window of opportunity".

First, ASA recommends that the Miller Act be amended to allow waiver of the 90 day waiting period when the subcontractor receives a denial of his claim from the prime contractor. There is no reason to require a subcontractor to wait 90 days when he knows that payment will not be forthcoming during that period.

ASA also recommends that the Miller Act be amended to allow the filing of suit up to one-year after anyone has furnished labor or material on the project. The one-year deadline which applies to the individual subcontractor is a serious problem, particularly for "early finishing" trades on projects where retainage is withheld. For example, a subcontractor whose work may be completed during the first few months of a two or three-year project, may have his final payment delayed for several years beyond his completion date. If he files suit within the one-year, the prime contractor and the surety may defend on the ground that the money is not yet due. If the subcontractor waits beyond the one year, he loses all rights under the Miller Act.

Finally, ASA recommends that that the Miller Act be amended to allow the awarding of attorneys' fees and interest under certain circumstances. Many assume that a prime contractor or

his surety settles payment claims upon receipt of notice and after investigation of the merits and validity of the claim. However, there have been many cases where the surety has raised groundless and technical defenses to a claim.

ASA believes that the Miller Act should be amended to allow the court to award attorneys' fees and interest to a subcontractor if the defenses raised against the claim are held groundless. Such amendment also should allow the surety to recover attorneys' fees if the subcontractor's suit is held frivolous.

ASA has prepared a bill your consideration that addresses each of these points. That draft plus other supporting materials are included with the detailed written statement accompanying my testimony, which we ask be incorporated in the formal record of this hearing.

Mr. Chairman, I thank you and the other members of this committee for your understanding of and ongoing support for construction subcontractors, and for this opportunity to discuss ASA's "issues and priorities".

I would, of course, be willing to respond to questions now or at any time in the future.



LEGISLATIVE SOLUTIONS
TO THE
PAYMENT PROBLEMS OF SUBCONTRACTORS
ON FEDERAL CONSTRUCTION

Statement of
AMERICAN SUBCONTRACTORS ASSOCIATION

to the

COMMITTEE ON SMALL BUSINESS
UNITED STATES SENATE

February 25, 1987

AMERICAN SUBCONTRACTORS ASSOCIATION, INC.
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(703) 684-3450



Legislative Solutions
to the
Payment Problems of Subcontractors on Federal Construction

The American Subcontractors Association is a national trade association with more than 6,500 firms representing all major construction trades in 55 chapters. In addition to its individual company members, ASA represents fifteen other specialty trade associations with members of their own (Attachment A).

ASA is the only national organization that speaks exclusively for the interests of construction subcontractors. ASA is dedicated to improving general business conditions for subcontractors through unified and cooperative actions.

In a survey of its members, ASA found that the most important issue facing construction subcontractors today is getting paid for work performed. Although concern about the nation's economy and the keen competition in the construction industry ranked high, the overwhelming majority of subcontractors participating in the survey reported that the inability to get paid in a timely manner is their most serious problem.

Subcontractors depend on the cash flow generated by progress payments to meet their payrolls and loan payments and to pay their subcontractors. Yet some prime contractors take 60, 90 or more days to pay their bills.

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For a big business, such a delay in payment would undoubtedly cause some consternation in the bookkeeping department, but business would go on as usual. For a small firm, the size of most construction subcontractors, however, one payment might mean the difference between survival and disaster.

ASA is working to solve the payment problems of subcontractors at all levels--in the private sector by talking to major construction investors and the financial institutions that loan them money; at the state level by seeking improvement to lien and other payment laws; and now at the federal level by asking you to help put the federal government's house in order.

Background

Fifty years ago the general contractor engaged to construct a building performed most of the work with his own forces, hiring craftsmen and tradesmen directly on his payroll for specialized building tasks. A system of payment grew naturally out of this arrangement: the owner paid the general contractor the amount due and the disbursement of funds to other parties, if any, was then the general contractor's responsibility.

Today, most general contractors perform only a small fraction of actual construction. On federal projects, that percentage is usually no more than 20 percent. Instead, work is subcontracted to firms that specialize in particular fields.

Now that subcontractors provide by far the majority of onsite labor and materials, the traditional payment system is

creating cash flow problems for those two and three steps down the payment process as those higher on the ladder divert funds for other business or personal uses thus delaying payment to those who actually perform the work.

Further pressure is placed on the system by factors such as:

- General and prime contractors who inflate the values for the various portions of the work in their requisitions than those represented by the amounts of individual subcontractors or purchase orders for those trades. This practice is called "front-end loading".
- General and prime contractors who are paid by the owner for the subcontractor's work who then fail to pay the subcontractor in a timely manner.

The net result is that construction subcontractors and suppliers often are paid at a slower pace than the rate at which an owner advances funds for a project.

The need is clear: modify the system of handling construction payments so that it will:

- (1) protect the owner and lender;
- (2) speed the flow of funds to those performing the work; and
- (3) still preserve the ability of the general contractor to control the job.

Federal Construction

Subcontractors' payment problems are perhaps more severe on federal construction projects than on private or other public work because of the exaggerated extent to which some agencies carry the principle of ignoring the existence of subcontractors in the absence of privity of contract.

Private owners are often quite mindful of the need for payment of subcontractors to assure performance and avoid liens. Thirteen states have laws which designate monies paid to prime contractors as trust funds and make it a criminal offense for a prime contractor to use the portions of these funds owed to subcontractors for any purpose other than payment of the subcontractors. Fifteen states have other explicit requirements of flow-through.

At the federal level, subcontractors have only two avenues to resolve the lack of payment:

- (1) a complaint to the contracting officer about the prime contractor's failure to pay after he has certified payment; and
- (2) a suit against the payment bond required under the Miller Act.

Certification of Payment. Several of the civilian agencies, including the General Services Administration and the Veterans Administration, require that a prime contractor:

". . . prior to receiving a progress or final payment . . . shall submit to the Contracting Officer a certification that the Contractor has made payment from proceeds of prior payments, or that he will make timely payment from the proceeds of the progress or final payment then due him, to his subcontractors and suppliers in accordance with his contractual arrangements with them."

Although the "Certification of Payment" requirement is a step in the right direction, there is no follow-up to assure its enforcement.

Even if a subcontractor complains about lack of payment, the most a contracting officer can do is to call the prime contractor and strongly suggest that payment be made. At this point, the prime contractor can, and usually does claim that the "contractual arrangement" with his subcontractors do not require payment at that time. The contracting officer has no way of knowing otherwise.

Even if the contracting officer desires to pursue the problem, he has no effective enforcement mechanism. Although a prime contractor who signed the "certification of payment" and then failed to pay his subcontractors is, in theory, defrauding the government, it is unlikely that the Department of Justice will file suit for the simple reason that the government has not suffered a direct financial loss.

Finally, it should be noted that even the "certification of payment" protection is not available on Department of Defense jobs.

Miller Act. In lieu of granting lien rights on federal projects, Congress enacted the Miller Act which, in addition to requiring a performance bond to guarantee completion of the project, requires a payment bond. The purpose of the Miller Act payment bond is to protect final payment to persons supplying labor and material on government projects where lien rights are unavailable.

The Miller Act has not lived up to the expectations of Congress. It is too costly and time-consuming for the small subcontractor to pursue. Generally, a subcontractor or supplier will only file suit under the Miller Act, and seek to obtain payment from the surety company that issued the bond, if the prime contractor appears to be insolvent and in danger of default to the government.

Even if the subcontractor decides to file suit under the Miller Act, he can only do so after 90 days from the date on which he last performed work or supplied material. Thus, the subcontractor has no recourse under the Miller Act for periodic progress payments unless he stops work on the project--an action that, presumably, the government would want to discourage.

In any event, the resulting delay in payment for months or even years can easily bankrupt a subcontractor.

Small Business and Federal Procurement Competition Enhancement Act. In 1984, Congress recognized the plight of small subcontractors in the "Small Business and Federal Procurement Competition Enhancement Act" (Public Law 98-577).

That Act states that it is:

. . . the policy of the United States that its prime contractors establish procedures to ensure the timely payment of amounts due pursuant to the terms of their subcontracts with small business concerns and small business concerns owned and controlled by socially and economically disadvantaged individuals."

Neither OFPP nor the individual agencies have taken action to implement this Act.

Legislative Solutions

In light of the ongoing payment problems of subcontractors on federal construction and the failure of federal agencies to find adequate solutions, ASA suggests that the time has come for congressional action.

After careful study, ASA recommends three legislative solutions to remedy subcontractor payment problems. They are:

- (1) prompt payment for subcontractors;
- (2) amendments to the Miller Act; and
- (3) criminal penalties for diversion of trust funds.

Prompt Pay for Subcontractors

Since the Prompt Payment Act took effect in October 1982, the federal government's payment practices have improved measurably.

But one thing has not improved--that is, the payment of subcontractors on federal construction.

Despite the example set by the federal government, many prime contractors have not followed suit in their dealings with subcontractors.

Thus, ASA believes it is time for Congress to follow the lead established by 15 states (Attachment B) and enact legislation that would require a prime contractor on federal construction to pay its subcontractors promptly after he receives payment from the federal government or face interest penalties.

S.328, the Prompt Payment Act Amendments of 1987, contains such a provision. Section 7, Payment Clause for Subcontracts under Construction Contracts, requires that a prime contractor on a federal construction project include a payment clause in its subcontract agreements which meets two basic standards.

First, the payment provision must conform with "prevailing industry standards". "Prevailing industry standards" is currently deemed to be seven days after the prime contractor is paid by the government.

Second, as an enforcement mechanism, Section 7 requires the agreement between a prime contractor and a subcontractor to

entitle the subcontractor to a late payment interest penalty at the same rate applicable between the prime contractor and the government, if the prime contractor fails to make payment in accordance with its subcontract's payment clause.

That is all Section 7 does!

Although at first Section 7 may be regarded as an intervention into the private contractual relationship between the general contractor and a subcontractor, a careful reading will show that the provision was drafted in a way that specifically preserves privity of contract. The government does not become a party to the subcontract or even to the mandated "prompt payment" provision. The government acquires no rights vis-a-vis the subcontractor nor does the subcontractor acquire rights vis-a-vis the government.

A mandatory pass-through provision of this nature is not uncommon in federal procurement. A review of the Federal Acquisition Regulation reveals an array of contract clauses currently required to be included in the subcontracts awarded by a prime contractor having a federal construction contract.

The American Bar Association's "Model FAR Compatible Fixed Price Construction Subcontract Terms" cites 28 clauses "which must be flowed down in some form under circumstances set forth in the FAR or the clause itself". These provisions address the full breadth of policy, practical and business interests of the government, including compliance with the specifications and

drawings, value engineering, and government access to subcontract cost and other data, as well as various socio-economic programs.

The argument that Section 7 would draw the government into disputes between a prime contractor and its subcontractors is specious. As noted above, the requirements of Section 7 do not impair the privity of contract between the government and the prime contractor. The resolution of disputes will remain between the prime contractor and the subcontractor, where they presently are.

As with the Prompt Payment Act's application between the prime contractor and the government, the subcontractor's entitlement to timely payment, or interest penalties for late payment, only applies when no dispute exists as to performance. The subcontractor is not entitled to payment if its performance is not in conformity with the project schedule or the government's specifications.

Similarly, the prime contractor may be entitled by its subcontract to withhold a payment for:

- (1) work that is in dispute;
- (2) third party claims, filed or reasonably expected to be filed;
- (3) alleged damages suffered by the prime contractor or another subcontractor; or
- (4) overdue subcontractor payments for labor, equipment or materials.

Under Section 7, the prime contractor remains completely free to make these determinations.

However, the prime contractor cannot collect payment from the government for the subcontractor's work and then fail to pay the subcontractor in a timely manner.

This is the heart of Section 7!

To assure equitable treatment of subcontractors, it is essential that a prime contractor identify subcontractor performance deficiencies and other claims in its application for payment, and any accompanying certificate, to the government and not request payment for amounts in dispute with the subcontractor until such dispute is resolved through negotiation, arbitration, or judicial action--that is, through whatever method is specified in the subcontract.

The money belongs to the government until it is paid to the prime contractor, and thereafter it belongs to the subcontractors and suppliers, except for that portion earned specifically by the prime contractor.

Indeed, to permit the prime contractor unlimited leeway in its determination of when payment should be made to a subcontractor for work for which the government has already paid, is to license the exercise of unreasonable leverage in the contracting process.

The federal government has every right to be concerned that subcontractors on its construction are paid in a timely manner.

The Prompt Payment Act of 1982 was enacted to alleviate the significant damaging effects which late government payments have on contractors, particularly small firms. The Act was intended to serve the government's needs by:

- Increasing the level of competition for government contract work by increasing the number of contractors willing to perform work on government projects;
- Decreasing the cost of government contracts by reducing the prevalent contractor practice of inflation of proposals for contracts in anticipation of slow payment; and
- Improving the quality and timeliness of government contracting performance by assuring timely payment to replenish working capital consumed in such performance by government contractors.

Unfortunately, the 1982 Act did not take into consideration the fact that subcontractors actually perform the majority of actual work on most federal construction projects.

Subcontractors are the ones first required to invest their working capital in the project and then are asked to wait the longest for their eventual payment, since payment from the government must pass through the "conduit" of the prime contractor.

Experience shows that prompt payment by the government to the prime contractor does not necessarily translate into prompt

payment to the subcontractors. The fact is many prime contractors take the same short-term view that many government agencies have in paying their bills--the longer payment can be delayed the better.

Yet Section 7 carefully avoids the problem of "premature" payment to subcontractors. It only mandates pass-through of amounts actually paid by the government to the prime contractor with respect to the work actually performed and satisfactorily completed by the subcontractor. The prime contractor will be assessed an interest penalty only if it fails to make payment to its subcontractors seven days after being paid by the government.

ASA believes that seven days is sufficient time for a prime contractor to pay his subcontractors. After all, the only thing the prime contractor has to do is write a check. He already accepted the subcontractor's work before incorporating the subcontractor's billing into the contractor's billing to the federal government.

Seven days is the maximum standard for subcontractor payment used in the private sector.

The American Institute of Architects (AIA) Document A401, Standard Form of Agreement Between Contractor and Subcontractor (1978 edition), provides for such payments to be made within three days after receipt of payment by the prime contractor (See Attachment C).

The Associated General Contractors of America (AGC) Document No. 600, Subcontract for Building Construction (August 1984), provides for such payments to subcontractors within seven days after receipt of payment by the prime contractor (See Attachment D).

So does a joint policy statement of ASA, the Associated General Contractors of America, and the Associated Specialty Contractors (See Attachment E).

However, these documents do not contain an enforcement mechanism appropriate for federal construction. For example, the interest provision in the AGC Form 600 does not meet the Prompt Payment Act standard, which applies between the government and the prime contractor. Second, the Form 600 makes the subcontractor's entitlement to any late payment interest penalty from the prime contractor contingent upon the prime being able to pass such interest costs along to the owner--even when that late payment is the prime contractor's fault. Section 7 would not permit the prime contractor to pass along to the government the cost of interest incurred when it pays its subcontractors late.

As noted above, contractors are builders, not bankers. And when contractors, at any tier, are paid late, the government will pay--directly or indirectly.

When subcontractors believe they will be paid late, the prime contractor and thus the government will receive higher bids on its projects, in some cases substantially over estimate.

On projects already under contract where little can be done by the subcontractor to alleviate unanticipated expenses caused by late payments, the cost to the government may take the form of delay. A subcontractor who has lost most of his profit expectation in a job but who still has a lot of work to complete, poses another kind of problem to the government.

A subcontractor cannot be expected to work for nothing and the government gets no "bargain" when a subcontractor is precluded from earning a reasonable profit.

ASA believes that Section 7 of S.328 would end late payment to subcontractors from prime contractors who routinely pay late in order to gain a competitive edge or to increase their profits. We strongly support this provision.

ASA would like to thank the members of the Small Business Committee for their leadership and support in seeking solutions to the payment problems of construction subcontractors. Every member of this Committee is a cosponsor of S.328, the Prompt Payment Act Amendments of 1987.

Amendments to the Miller Act

ASA believes that enactment of a "prompt pay for subcontractors" provision would end late pay to subcontractors from prime contractors who routinely pay late in order to gain a competitive edge or to increase their profits. It does not address a situation where a prime contractor cannot pay its subcontractors because of financial or other problems.

Congress recognized this issue when it enacted the Miller Act in 1935. The Miller Act provides for a performance bond for the protection of the government and a payment bond for the protection of the subcontractor or supplier on a federal construction project. At the time of enactment and later amendment, the Miller Act was considered to be a good law and, up to a point, it has been.

But the protection afforded by the Miller Act, as it stands today, is a snare and a delusion. Any subcontractor who has had experience with a suit on a Miller Act bond, will resort to it only when the prime contractor is hopelessly insolvent.

ASA believes that the Miller Act must be amended in several areas if it is to once again live up to the expectations of Congress--and more importantly, to protect the subcontractor and supplier on federal construction projects.

Require Treasury-Approved Bonds. First, ASA proposes that the Miller Act be amended to eliminate alternative securities to corporate bonds and to permit only bonds issued by surety companies approved by the U.S. Treasury Department.

Treasury already is required to approve the surety companies that issue bonds on federal projects. However, the regulations implementing the Miller Act also allow a contractor to post other types of securities in lieu of a corporate bond. These alternatives include certified or cashier's checks, bank drafts, money orders, U.S. bonds or notes, and even individual sureties.

The standards for such alternatives no where meet the strict standards for corporate sureties. A contractor who posts such an alternative to a corporate surety bond may not have been "prequalified" by an experienced agent and the liquidity of the "security" is not assured. In addition, the administration of such alternative securities is burdensome for the responsible government agency.

When alternative securities to corporate bonds are used on federal construction, subcontractors are at a greater risk since the government's first priority is assuring completion of the project--not payment of subcontractors who may have performed prior to the general contractor's default.

Require the Payment Bond Equal the Performance Bond. ASA also recommends that the Miller Act be amended to provide that the payment bond be at least equal to the performance bond.

Under the Miller Act, the government is protected by a performance bond in an amount the contracting officer "deems adequate for the protection of the United States." That amount is usually 100%.

Subcontractors, however, are protected by a payment bond which is only one-half of the contract amount if the contract is less than \$1 million; 40% of the contract amount if the contract is between \$1 million and \$5 million; and a \$2.5 million maximum if the contract is for more than \$5 million. The maximum dollar protection for a subcontractor under the Miller Act has been severely eroded by inflation. In any event, ASA believes that subcontractors deserve the same protection as the government is now granted under the Act.

Place an Affirmative Obligation on the Government. ASA further recommends that the Miller Act be amended to place an affirmative obligation on the government to assure prime contractor compliance with the Miller Act.

In the event that a Miller Act bond is not posted by the prime contractor, the contract is voidable and can be terminated by the government at its option. If the government does not terminate the contract, and the contractor defaults, the subcontractor claimant has no recourse to collect the money it is owed.

ASA believes it is wrong--and an abrogation of congressional intent--for a subcontractor to suffer a financial loss because of the government's failure to enforce the Miller Act.

Prohibit Waiver of Rights. In addition, ASA recommends that the Miller Act be amended to nullify any contract provision that would directly or indirectly waive a subcontractor's rights under the Miller Act.

Some agreements between a prime contractor and subcontractor require the subcontractor to waive these rights. Such subcontract provisions often are designed to protect the prime contractor and his surety by providing them with defenses on a bonded job. Given the uneven negotiating power between a prime contractor and subcontractor, ASA believes that such provisions--which operate to the legal and practical detriment of the subcontractor--should be against public policy.

Allow Notice by Certified Mail. ASA recommends that the Miller Act be amended to allow notices to be sent by certified or other system of mail by which receipt can be proven. The Miller Act requires that notice be given by "registered mail". Although most courts have excused this requirement when it is shown that a prime contractor actually received notice, it still may provide the surety with a technical defense to an otherwise recoverable Miller Act suit.

End "Premature Notice". The Miller Act requires certain subcontractors and suppliers to provide written notice to the prime contractor within 90 days from the date on which he performed the last labor or supplied the last of the material for which his claim is made. Some courts have ruled that notice

given before the actual final day of work is premature and therefore dismissed the suit. These court rulings provide the prime contractor and his surety with a technical defense to an otherwise recoverable Miller Act suit.

ASA recommends that the Miller Act be amended to require notice "not later than 90 days" (rather than "within 90 days") from the date of last furnishing.

Modify the Waiting Period for Filing Suit. The Miller Act requires a claimant to wait 90 days after he last performs labor or furnishes material on the project before filing suit. Although most courts have excused this requirement, it still may provide a surety with a technical defense to an otherwise recoverable Miller Act suit.

Thus, ASA recommends that the Miller Act be amended to allow waiver of the 90 day waiting period when the subcontractor receives a denial of his claim from the prime contractor. There is no reason to require a subcontractor to wait 90 days when he knows that payment will not be forthcoming during that period.

Extend the Period for Filing Suit. The Miller Act requires a subcontractor to file suit within one year from his last date of furnishing labor or material on a project. This is a serious problem, particularly for "early finishing" trades on projects where retainage is withheld.

For example, a subcontractor whose work may be completed during the first few months of a two or three-year project, may

have his final payment delayed for several years beyond his completion date. If he files suit within one year, the prime contractor and the surety may defend on the ground that the money is not yet due. If the subcontractor waits beyond the one year, he loses all rights under the Miller Act.

Therefore, ASA recommends that the Miller Act be amended to allow the filing of suit up to one-year after anyone has furnished labor or material on the project.

Allow Attorneys' Fees and Interest. Many assume that a prime contractor or his surety settles payment claims upon receipt of notice and after investigation of the merits and validity of the claim. However, there have been many cases where the surety has raised groundless and technical defenses to a claim.

So, finally, ASA recommends that that the Miller Act be amended to allow the court to award attorneys' fees and interest to a subcontractor if the defenses raised against the claim are held groundless. Such amendment also should allow the surety to recover attorneys' fees if the subcontractor's suit is held frivolous.

ASA has prepared a bill that addresses each of the above recommended amendments to the Miller Act. That bill is attached to this statement for your consideration (Attachment F).

Criminal Penalties for Diversion of Trust Funds

As noted above, the failure of contractors on public projects to channel funds received by them through the appropriate payments chain is a serious problem for construction companies doing business with the federal government.

Prime contractors who divert monies from the chain cause great hardship to subcontractors who may be unable to pay suppliers. Subcontractors who misappropriate funds injure both suppliers and primes, the latter often having to pay twice for the same services or materials.

Although civil law permits the recovery of a judgment against the party misusing the funds, it is of little consolation when obtained against an insolvent or bankrupt firm or individual.

As a result, the sureties who stand behind both the primes and the subcontractors, suffer financial damage. And, in the long run, the taxpayers end up paying the tab when public monies are improperly diverted or misappropriated from publicly funded projects.

In order to combat such flagrant abuses, some state legislatures have determined that it is a crime to divert funds disbursed for a construction project for self-serving use. A few states, such as New York and Wisconsin, have statutes that impose a fiduciary responsibility upon the recipients of construction funds. Under such legislation, funds are paid to an owner or

contractor with the implied understanding that they are to be maintained in trust until deserving parties are repaid. Only the leftover funds, or profit from the contract, may be diverted for use elsewhere. The criminal sanctions contained in these laws have made them virtually self-enforcing.

ASA is convinced that "trust fund" provisions have served well in several states to discourage diversion of funds, decrease owner vulnerability to liens and encourage the liberal extension of credit by subcontractors and suppliers. Such a provision benefits lenders, owners, construction firms, and suppliers.

The trust fund concept is also often used in the private sector. For example, the AIA Document A201, "General Conditions of the Contract for Construction (1976 edition), often called "the Bible" of the construction industry, requires the prime contractor to promptly pay each "Subcontractor, upon receipt of payment from the owner, out of the amount paid to the Contractor on account of such Subcontractor's Work, the amount to which said Subcontractor is entitled." The A201 also requires the prime contractor to, "by an appropriate agreement with each Subcontractor, require each Subcontractor to make payments to his Subcontractors in similar manner."

In addition, the AGC Document No. 600, Subcontract for Building Construction, recognizes the trust fund nature of relations between subcontractors and suppliers by requiring that "No payment received by the Subcontractor shall be used to

satisfy or secure any indebtedness other than one owed by the Subcontractor to a person furnishing labor or materials for use in performing the Subcontractor's Work."

ASA believes that the trust fund concept lends itself naturally to adoption at the federal level. Again, it should be recognized that the prime contractor, and often the subcontractor, is only a conduit for transmittal of payments from the federal government to those who have actually performed the work or supplied the material. The federal government has every right to be concerned that such payments are made on federal construction.

ASA has drafted a trust fund proposal for your consideration. (Attachment G).

This bill would provide that funds received by prime contractors and subcontractors as payment for work performed under contracts for the construction, alteration, or repair of any public building or public work of the United States constitute trust funds. It also would provide a criminal penalty--a fine of up to \$15,000, imprisonment up to 10 years or both unless the amount "stolen" is under \$100 in which case the fine would be limited to a maximum of \$1000 and imprisonment of not more than one year or both--for the use of such funds contrary to the trust.

Such a strong law should be available as a deterrent to the small percentage of firms or individuals who deliberately

appropriate other people's funds, realizing there is little consequence with which to be concerned. Where the consequences may include a criminal record or even incarceration, a different result obtains.

Adoption of the trust fund concept on a national level will produce immense benefits for all concerned. It will protect prime contractors from failing or unscrupulous subcontractors who would otherwise be tempted to divert or misappropriate funds received by them to non-project purposes. It will protect subcontractors from primes who are tempted to do the same. It will protect suppliers from misappropriation by either or both. It will protect sureties who stand behind the obligations of all. And, finally, it will protect American taxpayers by assuring that public funds will be used solely for the purposes for which they were authorized and obligated.

ASA asks the Congress to seriously consider this proposal.

Summary

Subcontractors on federal construction often have severe problems when trying to collect payment for completed work. In light of these ongoing problems and the failure of federal agencies to find adequate solutions, ASA believes that time has come for congressional action.

After careful study, ASA recommends three legislative proposals to remedy subcontractor payment problems on federal construction. They are:

- (1) prompt pay for subcontractors;
- (2) amendments to the Miller Act; and
- (3) criminal penalties for diversion of trust funds.

Although each of these legislative proposals stands alone, ASA believes that passage of all three is necessary to remedy subcontractor payment problems on federal construction.

ASA asks Congress to seriously consider and pass appropriate legislation as quickly as possible. ASA's members and resources are available to help in whatever way is necessary to expedite enactment of such legislation.



Attachment A

Members of
National Associations' Council
American Subcontractors Association

American Architectural Manufacturers Association
American Fire Sprinkler Association
American Institute of Steel Construction
Architectural Precast Association
Association of Drilled Shaft Contractors
Association of the Wall & Ceiling Industries - International
Ceiling and Interior Systems Construction Association
Concrete Sawing & Drilling Association
Institute of the Ironworking Industry
Insulation Contractors Association of America
National Association of Elevator Contractors
National Glass Association
National Ornamental & Miscellaneous Metals Association
National Roofing Contractors Association
Painting and Decorating Contractors of America

AMERICAN SUBCONTRACTORS ASSOCIATION, INC.
1004 DUKE STREET, ALEXANDRIA, VA 22314-3512
(703) 684-3450



Attachment B

States with
Prompt Pay Laws for Subcontractors

Connecticut
Florida
Hawaii
Louisiana
Massachusetts
Mississippi
Nevada
North Carolina
North Dakota
Pennsylvania
Rhode Island
South Dakota
Tennessee
Texas
Utah

THE AMERICAN INSTITUTE OF ARCHITECTS



AIA Document A401

SUBCONTRACT**Standard Form of Agreement Between
Contractor and Subcontractor****1978 EDITION**

Use with the latest edition of the appropriate AIA Documents as follows:

- A101, Owner-Contractor Agreement — Stipulated Sum
- A107, Abbreviated Owner-Contractor Agreement with General Conditions
- A111, Owner-Contractor Agreement — Cost plus Fee
- A201, General Conditions of the Contract for Construction.

**THIS DOCUMENT HAS IMPORTANT LEGAL CONSEQUENCES; CONSULTATION WITH
AN ATTORNEY IS ENCOURAGED WITH RESPECT TO ITS COMPLETION OR MODIFICATION**

This document has been approved and endorsed by the American Subcontractors Association
and the Associated Specialty Contractors, Inc.

12.4 PAYMENTS TO THE SUBCONTRACTOR

12.4.1 Unless otherwise provided in the Contract Documents, the Contractor shall pay the Subcontractor each progress payment and the final payment under this Subcontract within three working days after he receives payment from the Owner, except as provided in Subparagraph 12.4.3.

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THE ASSOCIATED GENERAL CONTRACTORS OF AMERICA

SUBCONTRACT FOR BUILDING CONSTRUCTION



5.2.5 TIME OF PAYMENT. Progress payments to the Subcontractor for satisfactory performance of the Subcontractor's Work shall be made no later than seven (7) days after receipt by the Contractor of payment from the Owner for such Subcontractor's Work.

This Agreement has important legal and insurance consequences. Consultation with an attorney and insurance consultant is encouraged with respect to its completion or modification and particularly when used with other than AIA A201 General Conditions of the Contract for Construction, August 1976 edition.



Joint policy statement 1: Prompt payment

Undue delays by owners, architects/engineers, general contractors, subcontractors and sub-subcontractors in processing amounts due to general contractors, subcontractors, sub-subcontractors and suppliers, or in making timely payments of these amounts, impose hardships and improper financing burdens on the contractors and suppliers and amount to extensions of credit by the contractors and suppliers to their respective higher tiers.

Accordingly, it is the policy of the Associated General Contractors of America, the American Subcontractors Association and the Associated Specialty Contractors that all payments must be made on all contracts promptly. This should include payment for all labor, services and materials stored on the job site or other approved storage sites as of the closing date of requisitions. This applies to both progress payments and final payments.

All local chapters of AGC, ASA and ASC are urged to make efforts, singly or cooperatively where possible, to persuade all owners, architects/engineers, general contractors, subcontractors and sub-subcontractors to adopt and adhere to this policy in the conduct of their business.

The following schedule of billings, certificates and payments by various participants in the construction process is recommended.

The schedule assumes normal trade contract terms allowing monthly progress payments for work performed and materials suitably stored through the end of the month. This schedule does not refer to payments to suppliers who are not subcontractors.

It is important to note that along the sequence of events, any recipient of a payment request who takes exception to an item of billing should immediately contact the initiating party by telephone and attempt to resolve the matter. Failing resolution, the party taking exception should notify the other party in writing the reasons for the action.

Day of Calendar Month	Event
20th	Sub-subcontractors request payment from subcontractors.
25th	Subcontractors request payment from contractor, incorporating the sub-subcontractor's request in the billing.
1st	Contractor submits to the owner's representative an itemized application for payment with the necessary supporting data, covering the monthly progress of the entire contract being performed.
5th	The owner's representative issues the certificate for payment to the owner for the amount requested.
10th or sooner	The owner makes payment to the contractor for the amount certified by the owner's representative.
No More Than 7 Days After Receipt	The contractor pays each subcontractor the amount received from the owner on his account promptly but not later than seven days after receipt.
No More Than 7 Days After Receipt	Each subcontractor pays each sub-subcontractor the amount received from the contractor on his account promptly but not later than seven days after receipt.

The schedule should be adjusted by making appropriate billings and payments on the last working day prior to any listed Saturday, Sunday or holiday. It is also recommended that collection efforts be commenced immediately following the day any payment due was not paid.

100th Congress
1st Session

Attachment F

S.

IN THE SENATE OF THE UNITED STATES

A BILL

To amend the Miller Act to guarantee completion of Federal Government construction projects and to protect persons supplying labor and materials on such construction.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

Section 1. This Act may be cited as the "Miller Act Amendments of 1987".

Sec. 2. The Congress finds that --

(1) the Miller Act, for many years, has operated to protect both the Federal Government and the persons supplying labor and materials on its construction projects;

(2) nonetheless, the changing nature of the construction industry and the surety industry, as well as a series of judicial rulings have weakened the protections

for the Government and its subcontractors and suppliers that Congress intended when the Act was enacted;

(3) as a result,

(A) neither the Government nor its subcontractors and suppliers are protected adequately when a prime contractor is permitted to post a bond issued by other than a corporate surety;

(B) the penal amount of the bond sometimes is not adequate to protect subcontractors and suppliers;

(C) failure of contracting officers to require an adequate bond can jeopardize both the Government and its subcontractors and suppliers; and

(D) technical defenses raised by prime contractors and their sureties jeopardize the recovery of otherwise valid claims under the Miller Act.

Sec. 3. That section 1 of the Act of August 24,

1935 (40 U.S.C. 270a, 49 Stat. 794), is amended -

(1) by deleting all of subsection (a) after "'contractor';" and inserting:

(1) A performance bond with an acceptable surety or sureties holding a certificate of

authority under sections 9304 and 9308 of Title 31 of the United States Code, and in a form satisfactory to the officer awarding such contract, and in such amount as he shall deem adequate, for the protection of the United States.

(2) A payment bond with an acceptable surety or sureties holding a certificate of authority under sections 9304 and 9308 of Title 31 of the United States Code, and in form satisfactory to the officer awarding such contract, and in an amount equal to the performance bond, for the protection of all persons supplying labor and material in the prosecution of the work provided for in said contract for the use of each such person.

(2) by adding as subsection (e) the following:

If the payment bond required by this Act is not furnished in the manner and form required under this Act, the United States shall be liable to all persons supplying labor or material in the prosecution of the work who would have been entitled to the protection of the bond, for any loss resulting to them from such failure.

(3) by adding as subsection (f) the following:

No promise or agreement by any person entitled to recover under a payment bond to waive any right under this Act shall be valid if made or entered into prior to the date of accrual of the right to sue on said bond.

That section 2 of the Act of August 24, 1985 (40 U.S.C. 270b; 49 Stat. 794), is amended -

(1) by striking out "within ninety days from" in the first sentence of subsection (a) and inserting in lieu thereof "not later than ninety days after."

(2) by striking out "registered mail" in the last sentence of the subsection (a) and inserting in lieu thereof "registered mail, certified mail, express mail, or other method of delivery which requires proof of receipt."

(3) by inserting after the last sentence of subsection (a) the following sentence: "Suit upon a payment bond shall not be dismissed on the ground that it was filed prior to the ninetieth day after the last of the labor was performed or material was furnished, provided such person suing shall have received from the contractor a denial, in whole or in part, of the claim."

(4) by striking out "him" in the first sentence of subsection (b) and inserting in lieu thereof "anyone".

(5) by inserting after the last sentence (b) the following sentences: "Upon a finding that suit against a contractor or surety is frivolous or defenses asserted are groundless, the prevailing party may be awarded attorneys' fees, court costs and interest established by the Secretary of the Treasury pursuant to Public Law 92-41 for the Renegotiation Board, as appropriate.

Sec. 4. The amendments made by this Act shall be applicable to any contract entered into 30 days after the date of the enactment of this Act.

100th Congress

Attachment G

1st Session

S.

IN THE SENATE OF THE UNITED STATES

A BILL

To provide that funds received by contractors and subcontractors as payment for work performed under contracts for the construction, alteration, or repair of any public building or public work of the United States constitute trust funds, and to provide a penalty for the use of such funds contrary to the trust.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress Assembled,

Section 1. That all monies paid or owing directly or indirectly to any contractor, subcontractor, or material supplier by the federal government for construction, alteration, or repair of any public building or public work of the United States, constitute a trust fund in the hands

of the prime contractor or subcontractor to the extent such monies are for the labor or materials used for such improvement, until all claims for such monies have been paid, but shall not be a trust in the hands of any person not a prime contractor or subcontractor who receives them in the ordinary course of business without knowledge of their trust nature. The use of such monies by any prime contractor or subcontractor for any other purpose until all claims have been paid in full or pro rata in the case of a deficiency, is theft and shall be punished under 18 U.S. C. 641.

Sec. 2. If the prime contractor or subcontractor is a corporation, such use shall also be deemed theft by any officer, director, or agency of the corporation who is responsible therefor.

Sec. 3. Until all claims have been paid in full, such monies and the right thereto shall not be subject to garnishments, execution, levy or attachments, and shall not be subject to any security interest in accounts receivable or general intangibles given by any prime contractor or subcontractor.

Sec. 4. Every person on whom a trust may be imposed by this section shall keep and maintain adequate books and records sufficient to segregate and identify

trust funds received on each specific contract, including a record showing the allocation to each trust of the deposits therein and withdrawals therefrom. Failure of the trustees to keep the books or records required by this section shall be presumptive evidence that the trustee has used or consented to the use of trust funds actually received by him in the form of money or an instrument for the payment of money, for purpose other than the purpose of the trust as specified in Section 1.

Sec. 5. Proof that funds paid to a prime contractor or subcontractor were trust funds as herein provided shall place a burden on such prime contractor or subcontractor or any successor to establish that any disbursements of the funds were consistent with the trust obligation.



March 9, 1987

The Honorable Dale Bumpers
Chairman
Committee on Small Business
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

During the Committee's recent hearing on "Issues and Priorities of Small Business", the Associated General Contractors of America asked, "What is the beef of the government . . ." in desiring passage of Section 7 (Payment Clause for Subcontracts under Construction Contracts) of S.328, the Prompt Payment Act Amendments of 1987?

The answer generally was that, if subcontractors are not paid in a timely manner, the government may suffer from delays, poor workmanship, and increased costs. Competition on federal construction will also be limited as subcontractors become reluctant to bid on federal jobs because of poor payment practices.

That is true. But it does miss an important point--one that, perhaps, explains AGC's stridency on this issue.

Section 7 would prevent prime contractors from "front end loading" on federal construction projects.

"Front end loading" is the practice of overvaluing the work of the early trades (e.g., steel, roofing) at the expense of the later trades (e.g., painting, flooring) on a project. As a result of "front end loading", the prime contractor collects more money from the government early in the job than has actually been earned either by himself or the subcontractors. The prime contractor may use that money to fund the start-up for the work to be performed by his own employees or, indeed, he may simply invest it for his own profit until he must pay the later finishing subcontractors.

AMERICAN SUBCONTRACTORS ASSOCIATION, INC.
1004 DUKE STREET, ALEXANDRIA, VA 22314-3512
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March 9, 1987
Page Two

Let me give you a simple example. The steel subcontractor contracts with the prime contractor to do a federal government project for \$1,000,000. A painting contractor contracts with that same prime to do the painting on that same government job for \$300,000. If the prime contractor chooses to front end load the project (a common practice in the construction industry), he will bill the government \$1,200,000 for the steel--\$200,000 more than the work is worth--at the beginning of the job. Later, the prime contractor will bill the government \$100,000 for the painting--\$200,000 less than the work is worth--at the end of the job. Meanwhile, the prime contractor has had the use of an unearned \$200,000 for many months, perhaps years.

Section 7 of S.328 would prevent "front end loading" by requiring a prime contractor to pay its subcontractors the total amount of money collected for their work within seven days after being paid for that work by the government. The prime contractor certainly will not pay a subcontractor more than the value of its work. Therefore, the current built-in incentive for "front end loading" will be removed.

Mr. Chairman, we hope this answers your question on this issue. We ask that this letter be incorporated in the formal hearing record of the hearing on "Issues and Priorities".

If there is any further way I or ASA can be of assistance, please feel free to contact me.

Sincerely,

Mac Sullivan

M.R. Sullivan, Jr.
Chairman
Government Relations Committee

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March 11, 1987

* ALSO ADMITTED IN DISTRICT OF COLUMBIA
 ** ALSO ADMITTED IN KENTUCKY AND IN NEW JERSEY
 - ALSO ADMITTED IN KENTUCKY AND IN OHIO

Ms. Colette Nelson
 Director of Government Relations
 American Subcontractors Association
 1004 Duke St.
 Alexandria, Va. 22314-3510

VIA: FEDERAL EXPRESS

Re: "Prompt Payment Act Amendments of 1987" (S-328)

Subject: Proposed Section 7 Regarding Application of
 Prompt Payment Principles to Subcontract Relationships
 on Government Projects

Dear Ms. Nelson:

At your request, I have reviewed the commentary prepared by King & King for the Associated General Contractors of America accompanying Mr. Harold Rosen's letter of February 18, 1987 to Mr. John W. Sroka setting forth AGC's opposition to inclusion of Section 7 in the final amendments to the Prompt Payment Act.

I enclose my comments responding to the AGC contentions and supporting inclusion of Section 7 and the application of Prompt Payment Act principles to subcontractors on federal projects. Such an extension of the Prompt Payment Act to subcontract relationships is entirely consistent with, if not necessary for, fulfillment of the legislative purpose underlying the Prompt Payment Act of 1982. Moreover, Section 7 of the proposed Amendments is not an unwarranted or unacceptable intrusion by the Federal Government into private contractual matters between government prime contractors and their subcontractors. Finally, principles of fundamental fairness support the concept that prompt Government payment relating to a subcontractor's work should be promptly passed through to him by the prime contractor upon receipt. It is not unfair or burdensome to apply essentially the same time limits and interest penalties to that stage of the payment process as apply at the prime contract level.

Ms. Collette Nelson
Page Two
March 11, 1987

I trust these comments will add to the momentum supporting the amendments generally, as well as Section 7 in particular, in the face of which AGC appears to stand virtually alone in its opposition. This opposition is curious in view of AGC's joinder with American Subcontractors' Association and Associated Specialty Contractors Association in the recent "Joint Policy Statement No. 1" regarding "prompt payment". In that statement these three national trade associations, speaking for virtually every constituency in the contractor side of the business, agreed that:

Undue delays by owners, architect/engineers, general contractors, subcontractors and sub-subcontractors in processing amounts due to general contractors, subcontractors, sub-subcontractors and suppliers, or in making timely payments of these amounts, imposed hardships and improper financing burdens on the contractors and suppliers and amount to extensions of credit by the contractors and suppliers to their respective higher tiers.

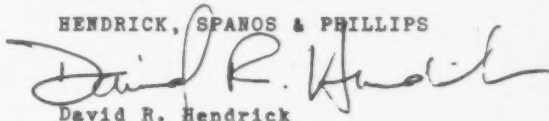
Accordingly, it is the policy of the Associated General Contractors of America, the American Subcontractors' Association and the Associated Specialty Contractors that all payments must be made on all contracts promptly.

As you know, that policy statement goes on to define the concept of "prompt" payment by specifying that the contractor should pay each subcontractor "the amount received from the owner on his account promptly but not later than seven days after receipt".

Please let me know if you wish any additional input or information from us.

Very truly yours,

HENDRICK, SPANOS & PHILLIPS



David R. Hendrick

DRH/esp
Enclosure

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COMMENTS SUPPORTING INCLUSION OF THE PROPOSED
SECTION 7 IN THE PROMPT PAYMENT ACT AMENDMENTS OF 1987

I.

INTRODUCTION

The declared purpose of the Prompt Payment Act of 1982 was to insure that contractors were paid promptly for labor, materials and services provided under contract to the federal government. Therefore, the 1982 Act stipulated certain time limitations within which such payment was to be made and provided for assessment of interest penalties on the government in the event such timely payments were not made. That Act dealt only with the prime contract relationship existing directly between the government contracting agency and the prime government contractor.

Section 7 of the currently proposed Amendments to the Act would simply extend the analogous right to prompt payment (and correlative right to an interest penalty in the event of untimely payment) to the "subcontractors" actually performing the predominant amount of on-site work on most government projects. This represents a logical and reasonable

extension of the "prompt payment" concept, and is, indeed, necessary to full realization of the practical benefits and policy objectives upon which the 1982 Act was predicated. In serving this strong and legitimate government interest while maintaining the proper independence of the government from application of such a subcontract provision, Section 7 is not unprecedented and does not constitute an unwarranted intrusion into private contractual relationships.

II.

SECTION 7 IS A LOGICAL AND NECESSARY EXTENSION OF THE PRINCIPLES UNDERLYING THE PROMPT PAYMENT ACT OF 1982

As proposed, Section 7 would mandate that all prime construction contracts awarded by a federal agency include a clause requiring the prime contractor, in turn, to include a "payment clause" in each "subcontract" entered relative to any such prime contract. That subcontract "payment clause" must obligate the prime contractor:

- (1) To pay the subcontractor promptly (as determined in accordance with the prevailing industry standards) out of amounts paid to the prime contractor by the agency for work performed by the subcontractor under that contract; and
- (2) To pay the subcontractor an interest penalty on amounts due in the case of each payment not made in accordance with such payment clause --
 - (A) For the period beginning on the day after the required payment date and ending on the date on which payment of the amount due is made; and

- (B) Computed at the most current rate of interest that has been determined by the Secretary of the Treasury for interest payments under Section 12 of the Contracts Dispute Act of 1978 (41 U.S.C. 611) and published by the Secretary in the Federal Register.

Section 7 then goes on to carefully stipulate that this payment clause does not constitute any obligation or contractual involvement by the United States relative to application and enforcement of rights under the subcontract.

The propriety of inclusion of Section 7 in the proposed Amendments must first focus on the legislative intention and objectives underlying the 1982 Act. In this regard, the legislative history makes clear the purpose of the Act was to alleviate the significant cost consequences arising out of untimely payment for work performed by contractors for the United States Government. See, U. S. Code Congressional and Administrative News, pp. 114-116. Accordingly, the Prompt Payment Act was intended to address the legitimate business needs of government contractors, especially small businesses, and thereby serve the government's own legitimate interests by:

(a) Increasing the level of competition for government contract work by increasing the number of contractors willing to perform work on government projects;

(b) Decreasing the cost of government contracts by reducing the prevalent contractor practice of inflation of proposals for government-related contracts in anticipation of slow payment; and

(c) Improving the quality and timeliness of government contracting performance by assuring timely payment to replenish working capital consumed in such performance by government contractors. Id.

However, full implementation of these objectives must further take into account the practical consideration that, by any measure, the vast majority of the work on any government project is actually performed by "subcontractors." Such subcontractors are at least one step removed in the payment process from the ultimate source of funds, the federal government, since payment must pass through the "conduit" of the prime contractor. The subcontractors are the ones first required to invest their working capital in the project and then are asked to wait the longest for their eventual payment.

This pragmatic consideration was not addressed in the 1982 Prompt Payment Act. Unfortunately, prompt payment by the government to the prime does not necessarily translate into prompt payments passed through to the subcontractors doing the bulk of the work. Indeed, this problem is recognized by the sponsors of the current amendments. See, "Introduction of S.328, the Prompt Payment Act Amendments of 1987." (Congressional Record, Senate, January 20, 1987, p. 8). Moreover, it is reinforced by recent surveys by the American Subcontractors Association confirming that the most important priority of subcontractors is timely payment for work performed. See, "Prompt Payment on Federal Construction, Statement of American

Subcontractors' Association to the Committee on Small Business" (United States Senate, June 19, 1986). Thus, Prompt Payment legislation addressing only the prime contract relationship falls significantly short of accomplishing the stated objectives of the Act.

Moreover, as compared with typical prime general contractors, subcontractors are more likely the "small business" entities which are hurt most by slow payment and conversely most benefited by prompt payment. Thus, again, the interests of subcontractors must be addressed in order to respond to the expressed concern of the co-sponsors of the current Amendments that the "most hard hit [by late payment problems] were the many small business government contractors, for whom the borrowing costs required to cover late government payments all too easily move a government contract from the firm's profit column to its loss column". See, "Introduction", supra, at p. 2.

Therefore, Section 7 is necessary to achievement of the stated objectives for federal prompt pay legislation and thus a proper addition to its scope.

III

"PREVAILING INDUSTRY STANDARDS" ARE SUFFICIENTLY PRECISE TO PERMIT REASONED APPLICATION OF SECTION 7

Concerning the practical applicability of the proposed Section 7, one must not lose focus of its principal thrust. Its primary purpose is to mandate a contractual interest penalty benefitting subcontractors on federal public works

when payment is not made promptly in accordance with "prevailing industry standards." This is not uncommon. Indeed, a recognized standard in the industry, the AIA Document A-201 ("General Conditions of the Contract for Construction") provides for assessment of interest for payments not made promptly. See subparagraph 7.8.1 and 9.5.2. Furthermore, this is substantially similar to the standard proposed for timing of construction progress payments under proposed Section 5 of the Amendments stipulating that prime government contracts must provide for the payment of interest on progress payments due "more than seven days" or a longer period if "the prevailing practice in private construction contracts is to provide such longer payment period."

Regarding prompt payment at the subcontract level, proposed Section 7 simply incorporates the similar concept of "prevailing industry standards". These standards are noted in the commentary accompanying the Amendments to require passthrough of payment by the prime contractor to the subcontractors no later than seven days after its receipt from the government. This is amply supported by not only the current version of the AIA Document A-401 ("Standard Form of Agreement Between Contractor and Subcontractor" (1978 Edition)), (see ¶ 12.4.1. requiring payment "within three working days") but also by a long history of evolution of documents produced by the Associated General Contractors of America, starting with the 1966 AGC-ASC "Standard Subcontract Agreement". (stipulating payment to the subcontractor

"within seven (7) days," Article 20) through the most recent version AGC Document No. 600, "Subcontract for Building Construction" (1984) (requiring payment to subcontractor "no later than seven (7) days" after receipt by the contractor, Article 5.2.5). More recently, AGC joined with ASA and Associated Specialty Contractors in promulgation of a joint policy statement recognizing that the industry practice requires that the contractor pay each subcontractor "the amount received from the owner on his account promptly but not later than seven (7) days after receipt." Joint Policy Statement No. 1, AGC, ASA, ASC (1984). (See Attachment A).

Certainly any subcontract payment clause providing for payment within, but no later than seven days after receipt by the prime would suffice within these standards. The critical element of Section 7, however, is the consequence of "interest" assessment that flows from the failure of the prime to promptly pass such payment along to the sub in accordance with the subcontract terms.

IV.

SECTION 7 IS NOT AN UNWARRANTED OR UNACCEPTABLE INTRUSION BY THE FEDERAL GOVERNMENT INTO PRIVATE CONTRACTUAL RELATIONSHIPS BETWEEN PRIME GOVERNMENT CONTRACTORS AND THEIR SUBCONTRACTORS

Quite clearly and expressly under the proposed language of Section 7, the government does not become a party to the subcontract or even to the mandated "prompt payment" provision. The government acquires no rights vis-a-vis the subcontractor nor does the subcontractor acquire rights vis-a-vis the govern-

ment. Thus, there is no violation of the concept of "privity" of contract as it applies to the relationship between the prime contractor and its subcontractors.

All Section 7 does is mandate inclusion of a provision in the prime contract which requires inclusion of a prompt payment clause in subcontracts. This serves the legitimate government interests underlying the entire prompt payment principle.

It is certainly not uncommon for the federal government to legislatively or administratively impose its will upon the contracting practices between government prime contractors and their subcontractors. Indeed, this concept of government mandated subcontract provisions on federal projects underlay the entire effort of the American Bar Association, Public Contract Law Section, in devising a model "FAR-Compatible Terms for Subcontracts Under Federal Government Fixed Price Construction Contracts" which was recently approved by the ABA House of Delegates in February of 1987. As the attached "Table of Contents" to the final draft of that Model form suggests (see Attachment B), there are numerous separate contract clauses that are mandated by statute or by regulation for inclusion in subcontracts and sometimes even sub-subcontracts as well on all federal projects. Indeed, the form even provides a model "disputes" resolution provision. The adoption by the ABA of this model form was again in the face of opposition by AGC. Indeed, this opposition was set forth in an AGC letter to Michael K. Love dated June 20, 1985, which

incidentally included another memorandum by King & King (see Attachment C) identifying a selection of fifteen of these mandatory "flow-down" provisions for inclusion in subcontracts on federal projects. As that memorandum correctly notes, these mandated subcontract clauses range from "socioeconomic" purposes to other government interest areas such as "patent law", "truth in negotiations" (regarding fraudulent claims and cost and pricing matters), "labor relations", "value engineering", and other substantive areas of concern. Examination of the comprehensive list of federally mandated subcontract provisions included in the recently approved ABA Model form discloses that they variously address the full breadth of policy, practical and business interests of the government and are not merely "socioeconomic" in nature. Thus, there are many instances in which the government has directly or indirectly influenced the "business" terms of subcontract relationships. Inclusion in government prime contracts of a clause requiring that all subcontracts include a prompt payment term would fit comfortably within this wide range of other mandated subcontract provisions serving the business as well as the public interest of the federal government.

The performance of the parties to the subcontract pursuant to a payment timing clause such as that proposed in Section 7, simply would not involve the government to any greater degree in subcontract matters than currently occurs. Thus, there is no need for concern regarding the federal government

injecting itself into subcontract claims or disputes or the direct resort by subcontractors against the government through administrative appeals, boards or courts.

V.

APPLICATION OF SECTION 7 IS NOT INCONSISTENT
WITH SUBCONTRACT BONDING PRACTICES AND WOULD NOT
SIGNIFICANTLY INCREASE THE PRIME CONTRACTOR'S RISK

Of course, at the prime contract level, the Miller Act (40 U.S.C. § 270a) requires the government contractor to provide payment and performance bonds. These security devices are to assure performance of its contractual obligations upstream to the owner as well as payment of its subcontractors and suppliers downstream in the contractual claim. While there is no such statutory compulsion requiring subcontractors to procure similar payment and performance bonds, they are generally available in most circumstances should the parties elect to use them. This is purely a business decision, usually at the instance of the prime contractor, which balances the additional cost of the bond against any benefit derived from reducing the risk of nonperformance.

However, this simply is not relevant to the issues raised by Section 7 of the proposed amendments. One must separate the concepts of "security" assuring future performance from the "timing" of payment for work already satisfactorily performed. There is simply no justification arising out of these bonding considerations warranting

delayed or retained payment by the prime contractor to the extent that a subcontractor has performed work over which there is no dispute and for which the prime contractor has actually received payment from the government.

The issue of "security" for future performance can be dealt with in numerous ways such as requiring payment and performance bonds, requiring guarantees of performance, providing for retainage to be held until final completion. The mandated prompt payment term, on the other hand, only operates when there is no dispute regarding the subcontractor's work for which the owner has already promptly paid the prime contractor. The prime contractor's rights of additional withholding or setoff arising out of other subcontract provisions relating to defaults and breaches would operate in conjunction with the payment provisions. Exercise of such rights would not be inconsistent with the mandated clause regarding timing of undisputed payment.

VI.

SECTION 7 WILL NOT UNDULY INVOLVE THE FEDERAL GOVERNMENT IN THE ADMINISTRATION OF SUBCONTRACT PAYMENT MATTERS

The only issue of concern of the federal government raised by the proposed Section 7 is whether the prime contract, in fact, includes the mandated language requiring, in turn, the payment clause in all subcontracts. Beyond that, the government has no involvement in the administration or enforcement of

the subcontract payment clause requirements. Indeed, the clause expressly negates any such interest of the government in the actual application of the clause. This leaves the parties to the subcontract to resolve any resultant disputes by conventional mechanisms available for resolving issues between prime contractors and subcontractors.

The commentary accompanying the proposed Amendments notes that Section 8(d) of the Small Business Act (15 U.S.C. § 637(d)) may require a contracting officer to insure compliance with certain subcontract provisions. Nevertheless, this applies with equal force to involve the contracting officer in the enforcement of all subcontract provisions and procedures bearing upon the purpose of that Act. Consequently, inclusion of Section 7 in the Prompt Payment Act scheme would not add to the burden or the level of substantive involvement of a federal contracting officer in small business subcontract relationships beyond that already existent.

Finally, the proposed Section 7 would not unduly infringe upon the rights of the parties to a subcontract to establish the terms of entitlement to and conditions and amount of payment. Section 7 only addresses timely pass through of the government's money and all other terms are left to the parties.

VII.

SECTION 7 CAN BE ADMINISTERED CONSISTENT WITH EXISTING SUBCONTRACT PAYMENT PRACTICES

Nothing in Section 7 requires deviation from the long es-

established method for processing of subcontractor payments with the sole exception that the amounts due are to be paid promptly within the terms of the Act. The method of attribution to the various subcontractors of the amount of the payments received by the prime contractor is not changed. For example, the AIA Document A-201 ("General Conditions of the Contract for Construction" (1976)) provides a standard in requiring that the prime contractor promptly pay each subcontractor out of the amount paid by the owner on account of such subcontractor's work "the amount to which said subcontractor is entitled, reflecting the percentage actually retained, if any, from payments to the contractor on account of such subcontractor's work." Subparagraph 9.5.2.

The prime contractor's established method of aggregating subcontractor pay requests and supplier invoices and incorporating them into his own periodic pay request is not affected at all by Section 7. Neither is the method changed of apportioning to the various subcontractors the amounts received from the owner pursuant to the prime's request for payment. Section 7 only obligates the prime to include a subcontract clause requiring prompt pass through of those apportioned amounts.

Moreover, Section 7 would not require "premature" final payment of any subcontractors. It would only mandate pass through of amounts actually paid by the owner to the prime contractor with respect to the work actually performed and satisfactorily completed by the subcontractor.

VIII.

CONCLUSION

Only by extending the protection of the Act to the sub-contract level can the government realize the substantial benefits set forth in the congressional findings and statement of purpose underlying the proposed Amendments. In adopting proposed Section 7 of the Amendments, Congress would be doing nothing more than applying a concept of fundamental fairness by affording the subcontractors the same rights and assurances of prompt payment as now benefit prime contractors on federal projects. Once the government has paid the prime contractor for successful performance of a subcontractor's work, the subcontractor is equally entitled to receive timely prompt payment from the prime for such work. Indeed, to permit the prime contractor unlimited leeway in its determination of when payment should be made to a subcontractor for work for which the owner has already paid, is to license the exercise of unreasonable leverage in the contracting process. This would be entirely counterproductive of the spirit and objectives of the Prompt Payment Act from the government's perspective.

Since the federal government has deemed it necessary to mandate prompt payment to the prime contractors, primes should now be required to promptly pass such payments through to the subcontractors actually performing the work. This substantial governmental interest served will far outweigh any minimal intrusions resulting in subcontracting practices for federal projects.



Joint policy statement 1: Prompt payment

Undue delays by owners, architects/engineers, general contractors, subcontractors and sub-subcontractors in processing amounts due to general contractors, subcontractors, sub-subcontractors and suppliers, or in making timely payments of these amounts, impose hardships and improper financing burdens on the contractors and suppliers and amount to extensions of credit by the contractors and suppliers to their respective higher tiers.

Accordingly, it is the policy of the Associated General Contractors of America, the American Subcontractors Association and the Associated Specialty Contractors that all payments must be made on all contracts promptly. This should include payment for all labor, services and materials stored on the job site or other approved storage sites as of the closing date of requisitions. This applies to both progress payments and final payments.

All local chapters of AGC, ASA and ASC are urged to make efforts, singly or cooperatively where possible, to persuade all owners, architects/engineers, general contractors, subcontractors and sub-subcontractors to adopt and adhere to this policy in the conduct of their business.

The following schedule of billings, certificates and payments by various participants in the construction process is recommended.

The schedule assumes normal trade contract terms allowing monthly progress payments for work performed and materials suitably stored through the end of the month. This schedule does not refer to payments to suppliers who are not subcontractors.

It is important to note that along the sequence of events, any recipient of a payment request who takes exception to an item of billing should immediately contact the initiating party by telephone and attempt to resolve the matter. Failing resolution, the party taking exception should notify the other party in writing the reasons for the action.

Day of Calendar Month

Event

20th	Sub-subcontractors request payment from subcontractors.
25th	Subcontractors request payment from contractor, incorporating the sub-subcontractor's request in the billing.
1st	Contractor submits to the owner's representative an itemized application for payment with the necessary supporting data, covering the monthly progress of the entire contract being performed.
5th	The owner's representative issues the certificate for payment to the owner for the amount requested.
10th or sooner	The owner makes payment to the contractor for the amount certified by the owner's representative.
No More Than 7 Days After Receipt	The contractor pays each subcontractor the amount received from the owner on his account promptly but not later than seven days after receipt.
No More Than 7 Days After Receipt	Each subcontractor pays each subcontractor the amount received from the contractor on his account promptly but not later than seven days after receipt.

The schedule should be adjusted by making appropriate billings and payments on the last working day prior to any listed Saturday, Sunday or holiday. It is also recommended that collection efforts be commenced immediately following the day any payment due was not paid.

Attachment "A"

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10/11/86

Attachment "g"

TABLE OF CONTENTS

	<u>Page</u>
1. SUBCONTRACTOR OBLIGATIONS, RIGHTS AND RESPONSIBILITIES.....	1
2. SUBCONTRACTOR NOTICE REGARDING GOVERNMENT REQUIREMENTS.....	1
3. CHOICE OF LAW.....	2
4. FAR 52.203-3 -- GRATUITIES (APR 1984).....	2
5. FAR 52.203-5 -- COVENANT AGAINST CONTINGENT FEES (APR 1984).....	3
6. *FAR 52.204-2 -- SECURITY REQUIREMENTS (APR 1984).....	4
7. *FAR 52.208-1 -- REQUIRED SOURCES FOR JEWEL BEARINGS AND RELATED ITEMS (APR 1984).....	5
8. FAR 52.212-12 -- SUSPENSION OF WORK (APR 1984)	7
9. * FAR 52.214-26 -- AUDIT - SEALED BIDDING (APR 1985).....	8
10. FAR 52.214-27 -- PRICE REDUCTION FOR DEFECTIVE COST OR PRICING DATA - MODIFICATIONS - SEALED BIDDING (APR 1985).....	9
11. *FAR 52.214-28 -- SUBCONTRACTOR COST OR PRICING DATA - MODIFICATIONS - SEALED BIDDING (APR 1985).....	10
12. *FAR 52.215-1 -- EXAMINATION OF RECORDS BY COMPTROLLER GENERAL (APR 1984).....	12
13. *FAR 52.215-2 -- AUDIT - NEGOTIATION (APR 1984)	12
14. FAR 52.215-22 -- PRICE REDUCTION FOR DEFECTIVE COST OR PRICING DATA (APR 1984).....	14
15. *FAR 52.215-24 -- SUBCONTRACTOR COST OR PRICING DATA (APR 1985).....	14

* FAR Clause which must be flowed down in some form under circumstances set forth in the FAR or the clause itself.

- 1 -

SOURCE: FINAL DRAFT (10/86)
OF ABA MODEL "FAR-COMPATIBLE"
TERMS FOR SUBCONTRACTS UNDER FEDERAL
GOVERNMENT FIXED PRICE CONSTRUCTION
CONTRACTS. APPROVED BY ABA in 2/87.

NOT APPROVED or RECOMMENDED by American Bar Association or its Section of Public Contract Law. Not for public distribution.

10/11/86

1		
2	16. FAR 52.219-8 -- UTILIZATION OF SMALL BUSINESS CONCERNS AND SMALL DISADVANTAGED BUSINESS CONCERNS (JUN 1985).....	16
3		
4	17. *FAR 52.219-9 -- SMALL BUSINESS AND SMALL DISADVANTAGED BUSINESS SUBCONTRACTING PLAN (APR 1984).....	17
5		
6	18. FAR 52.219-13 -- UTILIZATION OF WOMEN-OWNED SMALL BUSINESSES (APR 1984).....	21
7		
8	19. *FAR 52.220-3 -- UTILIZATION OF LABOR SURPLUS AREA CONCERNS (APR 1984).....	21
9		
10	20. *FAR 52.220-4 -- LABOR SURPLUS AREA SUBCONTRACTING PROGRAM (APR 1984).....	22
11	21. *FAR 52.222-1 -- NOTICE OF LABOR DISPUTES (APR 1984).....	23
12		
13	22. *FAR 52.222-4 -- CONTRACT WORK HOURS AND SAFETY STANDARDS ACT - OVERTIME COMPENSATION (MAR 1986).....	24
14		
15	23. *FAR 52.222-26 -- EQUAL OPPORTUNITY (APR 1984).....	25
16	24. *FAR 52.222-27 -- AFFIRMATIVE ACTION COMPLIANCE REQUIREMENTS FOR CONSTRUCTION (APR 1984).....	27
17	25. *FAR 52.222-35 -- AFFIRMATIVE ACTION FOR SPECIAL DISABLED AND VIETNAM ERA VETERANS (APR 1984).....	33
18		
19	26. *FAR 52.222-36 -- AFFIRMATIVE ACTION FOR HANDICAPPED WORKERS (APR 1984).....	37
20		
21	27. *FAR 52.223-1 -- CLEAN AIR AND WATER CERTIFICATION (APR 1984).....	39
22	28. *FAR 52.223-2 -- CLEAN AIR AND WATER (APR 1984).....	39
23	29. *FAR 52.223-3 -- HAZARDOUS MATERIAL IDENTIFICATION AND MATERIAL SAFETY DATA (APR 1984).....	41
24		
25	30. *FAR 52.225-5 -- BUY AMERICAN ACT - CONSTRUCTION MATERIALS (APR 1984).....	42
26	31. *FAR 52.227-1 -- AUTHORIZATION AND CONSENT (APR 1984).....	43
27		
28		

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Law. Not for public distribution.

10/11/85

1	32. *FAR 52.227-2 -- NOTICE AND ASSISTANCE REGARD-	
2	ING PATENT AND COPYRIGHT INFRINGEMENT	
	(APR 1984).....	44
3	33. FAR 52.227-4 -- PATENT INDEMNITY -	
4	CONSTRUCTION CONTRACTS (APR 1984).....	44
5	34. *FAR 52.228-5 -- INSURANCE - WORK ON A GOVERN-	
6	MENT INSTALLATION (APR 1984).....	45
7	35. FAR 52.229-3 -- FEDERAL, STATE, AND LOCAL	
8	TAXES (APR 1984).....	45
9	36. FAR 52.229-5 -- TAXES - CONTRACTS PERFORMED	
10	IN U.S. POSSESSIONS OR PUERTO RICO (APR 1984) .	46
11	37. FAR 52.233-1 -- DISPUTES.....	46
12	38. FAR 52.232-17 -- INTEREST (APR 1984).....	48
13	39. FAR 52.236-2 -- DIFFERING SITE CONDITIONS	
14	(APR 1984).....	49
15	40. FAR 52.236-3 -- SITE INVESTIGATION AND	
16	CONDITIONS AFFECTING THE WORK (APR 1984).....	50
17	41. FAR 52.236-5 -- MATERIAL AND WORKMANSHIP	
18	(APR 1984).....	51
19	42. FAR 52.236-7 -- PERMITS AND RESPONSIBILITIES	
20	(APR 1984).....	52
21	43. FAR 52.236-8 -- OTHER CONTRACTS (APR 1984)....	52
22	44. FAR 52.236-9 -- PROTECTION OF EXISTING VEGETA-	
23	TION, STRUCTURES, EQUIPMENT, UTILITIES, AND	
24	IMPROVEMENTS (APR 1984).....	53
25	45. FAR 52.236-10 -- OPERATIONS AND STORAGE AREAS	
26	(APR 1984).....	53
27	46. FAR 52.236-12 -- CLEANING UP (APR 1984).....	54
28	47. *FAR 52.236-13 -- ACCIDENT PREVENTION	
	(APR 1984).....	54

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10/11/86

1	48. FAR 52.236-15 -- SCHEDULES FOR CONSTRUCTION	
2	CONTRACTS (APR 1984).....	55
3	49. FAR 52.236-17 -- LAYOUT OF WORK (APR 1984)....	56
4	50. *FAR 52.236-21 -- SPECIFICATIONS AND DRAWINGS	
5	FOR CONSTRUCTION (APR 1984).....	57
6	51. FAR 52.243-4 -- CHANGES (APR 1984).....	58
7	52. FAR 52.246-12 -- INSPECTION OF CONSTRUCTION	
8	(APR 1984).....	60
9	53. *FAR 52.247-63 -- PREFERENCE FOR U.S.-FLAG AIR	
10	CARRIERS (APR 1984).....	62
11	54. *FAR 52.247-64 -- PREFERENCE FOR PRIVATELY	
12	OWNED U.S.-FLAG COMMERCIAL VESSELS (APR 1984).	63
13	55. *FAR 52.248-3 -- VALUE ENGINEERING -	
14	CONSTRUCTION (APR 1984).....	64
15	56. FAR 52.249-2 -- TERMINATION OF THE CONTRACTOR	
16	FOR CONVENIENCE OF THE GOVERNMENT (FIXED-PRICE)	
17	(APR 1984).....	68
18	57. FAR 52.249-10 -- DEFAULT TERMINATION OF THE	
19	* CONTRACTOR (FIXED-PRICE CONSTRUCTION).....	69
20		
21		
22		
23		
24		
25		
26		
27		
28		



THE ASSOCIATED GENERAL CONTRACTORS OF AMERICA

1957 E Street, N.W. • Washington, D.C. 20006 • (202) 393-2040 • TWX: 710-822-9406 AGC WSH

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June 20, 1985

RECEIVED

JUN 21 1985

Mr. Michael K. Love
Wickwire, Gavin & Gibbs, P.C.
Suite 400
8230 Boone Boulevard
Vienna, Virginia 22180

WICKWIRE
GAVIN & GIBBS, P.C.

Dear Mike:

As explained at our April 24 meeting, AGC has great concerns regarding the involvement of the ABA in developing a standard form of subcontract for fixed-price federal construction work. As you know, we regard this effort as an intrusion by ABA into the relationship between government owners and general contractors and, similarly, an intrusion into the relationship between general contractors and subcontractors. Additionally, there has been no expressed need from any of these parties -- government owners, general contractors or subcontractors -- to have ABA develop such a form.

At an April 4 meeting of our association's President, Vernie G. Lindstrom, Jr., with ABA President John C. Shepherd and Judge Ruth Burg, Mr. Shepherd and Judge Burg indicated that the objective of ABA was not to draft an entire subcontract agreement but rather to draft contract provisions which, by virtue of the FAR, are mandated to flow-down to subcontractors.

President Lindstrom has already advised Mr. Shepherd and Judge Burg that AGC is totally opposed to any model clauses that would go beyond these mandatory "flow-down" provisions and include provisions which reflect judgmental business decisions, such as terms and conditions for payment, retention, among many others.

Our research reveals that there are fourteen mandatory "flow-down" provisions emanating from the FAR and its underlying statutes. (see attachment).

In furtherance of the April 4 discussions amongst the ABA and AGC principals, we request the following:

- 1) That this letter, with attachment, be shared with all members of the ABA Subcontracting Committee of the State and Local Procurement Division and the Drafting Group of that Subcontracting Committee.

Attachment "C"

THE FULL SERVICE CONSTRUCTION ASSOCIATION FOR FULL SERVICE MEMBERS

Mr. Richard K. Love
Page Two
June 20, 1985

- 2) That AGC be advised as to whether the Drafting Group
tracting Committee will, in fact, limit their efforts
attached mandatory "flow-down" clauses.

We request these actions so as to gauge AGC's interest in
ing in this effort or in pursuing other courses of action.

Sincerely,



John W. Sroka
Executive Director
Occupational Divisions

Attachment

cc: John C. Shepherd, President, ABA
Judge Ruth C. Burg
Vernie G. Lindstrom, Jr., President, AGC
Hubert Beatty, Executive Vice President, AGC

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ATTACHMENT 1

List Of Mandatory Subcontract Flow-Down Clauses

<u>Clause</u>	<u>Program Implemented</u>	<u>FAR References</u>	<u>Conditions For Implementation</u>
1. Equal Opportunity	socio-economic	22.810(e) 52.222-26	contracts and subcontracts in excess of \$10,000; contracts not otherwise exempt by terms of Executive Order 11246
2. Affirmative Action Compliance Requirements For Construction	socio-economic	22.810(f) 52.222-27	contracts in excess of \$10,000 contracts including Equal Opportunity clause
3. Affirmative Action For Special Disabled and Vietnam Era Veterans	socio-economic	22.1308 52.222-35	contracts in excess of \$10,000
4. Affirmative Action For Handicapped Workers	socio-economic	22.1408 52.222-36	contracts in excess of \$2,500
5. Clean Air and Water	environment	23.105(b) 52.223-2	contracts in excess of \$100,000 unless facility is on EPA List of Violating Facilities
6. Clean Air and Water Certification	environment	23.105(a) 52.223-1	contracts containing Clean Air and Water clause

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- 2 -

<u>Clause</u>	<u>Program Implemented</u>	<u>FAR References</u>	<u>Conditions For Implementation</u>
7. Authorization and Consent	patents	27.201-2 52.227-1	contracts in excess of \$25,000
8. Notice and Assistance Regarding Patent and Copyright Infringement	patents	27.202-2 52.227-2	contracts in excess of \$25,000
9. Audit-Sealed Bidding	truth-in-negotiations	14.201-7(a) 52.214-26	contracts in excess of \$100,000 and subcontracts in excess of \$10,000
10. Subcontractor Cost or Pricing Data-Modifications-Sealed Bidding	truth-in-negotiations	14.201-7(c) 52.214-28	subcontracts in excess of \$100,000
11. Specifications and Drawings for Construction	special construction	36.521 52.236-21	contracts in excess of \$25,000
12. Notice to the Government of Labor Disputes	labor*	22.103-5. 22.101-1(e) 52.222-1	when head of contracting activity determines necessity for notification of potential or actual labor dispute
13. Insurance-Work on a Government Installation	insurance	28.310 52.228-5	for contracts involving work on a government installation
14. Buy American Act-Construction Materials	buy-America**	25.205 52.225-5	

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- 3 -

<u>Clause</u>	<u>Program Implemented</u>	<u>FAR References</u>	<u>Conditions For Implementation</u>
15. Value Engineering- Construction	value- engineering**	48.202 52.248-3	contracts in excess of \$100,000 and subcontracts in excess of \$50,000

* At the present time, this the only labor related provision in the FAR that requires a mandatory flow down clause. However, FAR Part 22.4 has been reserved to implement labor standard statutes and the section is being drafted now and will undoubtedly add some mandatory flow-down provisions.

** Specific working of subcontract clause is not prescribed. However, some subcontract coverage is mandatory.



March 19, 1987

Subcontractors
Talk about
Slow Pay on Federal Construction

The Associated General Contractors of America has emphasized that Section 7 (Payment Clause for Subcontracts under Construction Contracts) of S.328, the Prompt Payment Act Amendments of 1987, is not worthy of even consideration by the United States Senate because the problem of late payments is an illusory one. AGC maintains that the only reason that subcontractors experience late payments is because the government has failed to make timely payments to the prime contractor.

To document the problems being confronted by construction subcontractors and to, lay to rest AGC's argument that prime contractors do not delay payment to subcontractors, we have compiled excerpts from communications to ASA in which subcontractors share their very real problems in their own words.

* * * * *

Alaska

We recently did work at Eielson Air Force Base. Our pay lagged 60 to 90 days from the time the general contractor was paid, and ours wasn't the only incidence of this abuse. We complained several times to the Corps of Engineers, but since we were subcontractors, they could do nothing.

Lawrence M. Slay, Jr.
Acme Electric Company, Inc.
Fairbanks, Alaska

In 1984, I did a \$22,000 job on Elmendorf. I got paid \$10,000. The balance of \$12,000 has never been paid. The Base officials said, "The general contractor has been paid; we cannot help you!"

Marie Wilson
Warning Lites of Alaska, Inc.
Anchorage, Alaska

I am a subcontractor doing a gross annual business between \$300,000 and \$900,000 of which approximately 90% is on public work and has been for ten years. Since mid-1985, I have had over \$300,000 of contracts where general contractors did not pay me within 60 days after receipt of monies from the Government.

James G. Marson
J.G. Marson Mosaic & Tile
Anchorage, Alaska

AMERICAN SUBCONTRACTORS ASSOCIATION, INC.
1004 DUKE STREET, ALEXANDRIA, VA 22314-3512
(703) 684-3450

Arizona

I estimate that I have lost in the neighborhood of \$330,000 due to "no pay" by general contractors since I began my business in 1953. The losses due to slow pay are even higher. Twenty percent of my time plus ten percent of two other people's time is spent in collections. I have had to borrow money many times--paying as much as 23.5 percent interest while having as much as \$350,000 outstanding in uncollectable receivables.

A good example of slow pay occurred on a recent job for the U.S. Air Force. I received one-half of my retention only after a significant delay. Whenever I checked, the general contractor told me he had not yet been paid. Yet the check stub that was accidentally included with my payment showed he had received full payment 37 days earlier. I believe this kind of delay is standard practice among general contractors.

A.L. McCune
A.L. McCune Dry Wall Company, Inc.
Tucson, Arizona

Arkansas

During the last year, I have worked on two projects for the U.S. Postal Service. On one project, I have been owed \$22,000 for nearly nine months. On the second, I have been owed over \$6,000 for four months. In both cases, the prime contractor has been paid.

Dan Billingsley
Tile Center, Inc.
Benton, Arkansas

Florida

The ability to manage cash flow in a company becomes very difficult when a contractor, who has been paid, does not pay his or her subcontractors promptly. Money tied up in labor and material costs sits idle and cannot be invested in future projects. Progress grinds to a halt and your business associates begin to look elsewhere for their needs.

Samuel B. Sasser
Sasser's Glass Works, Inc.
West Palm Beach, Florida

Florida

As a subcontractor who has worked on numerous federal jobs, we have experienced the hardships caused by the lack of our cash flow brought on by the prime contractor, who while having received payment for our work, has not paid us. Routinely, prime contractors collect for a subcontractor's work he certifies to the government as complete, but withholds the monies due the subcontractor claiming his lack of performance. In addition to the hardship caused the subcontractor, the prime contractor is unjustly enriched from the use of the subcontractor's money. Often the prime contractor will drag out such payments to the subcontractor for as long as three to six months.

Hugh Munnell
Brown Automatic Sprinklers, Inc.
Tampa, Florida

Georgia

In January 1985, our firm contracted with a subcontractor for work to be performed at the Maxwell Air Force Base Area Exchange in Alabama. In other words, we were a sub-subcontractor on the job. In September 1986, not having received payment for our last three invoices (\$5892.85) or our retainage (\$1666.15), I wrote to the Army & Air Force Exchange Service requesting information on the project, including whether the general contractor had been paid. The only response was a letter with a routine recitation of my rights under the Miller Act. Nonetheless, it is my understanding, that the general contractor on this project was, indeed, paid. But the subcontractor, and thus our company, has not been paid. It is my personal belief that the subcontractor payment language being considered by the Senate would go a long way toward ending this kind of routine non-payment by general contractors.

Jack M. Cherry
Columbus Automatic Door, Inc.
Columbus, Georgia

Louisiana

In one Department of Defense job in our area, the prime contractor left over \$1,000,000 in retainage on the job. Because of front-end loading, the prime had collected all his money from the job by that time; the remaining \$1,000,000 was for work performed by the various subcontractors. Obviously, these subcontractors were never paid.

Russell Stratton
Stratton, Inc.
Lake Charles, Louisiana

Maryland

As a subcontractor (many times a sub-subcontractor) on government projects, we have experienced payment delays even though the general contractor has been paid. Prompt payment assures a good working relationship between all parties. The owner and all parties involved may suffer time delays, increased overhead and poor workmanship if this relationship breaks down. Competition may also be limited due to subcontractors reluctance to bid these jobs because of payment.

Allan L. Baggott
Controls Systems Sales, Inc.
Laurel, Maryland

Maine

Our company frequently does military contracting work. We, however, have had to adopt a policy of no subcontracting except to companies in-state with whom we already do non-military work. This is because we have been taken so many times by so many military prime contractors. We have no protection, as a practical matter, under the law. The federal government's payment policies permit the large prime contractor to abuse his subs if he so desires. We should not allow the fox to care for the chickens.

Chris Wetherall
Industrial Vacuum Company
Portland, Maine

Maine energy is leaning away from bidding on government jobs due to the fact of late payments. We are not alone in this area; therefore, it takes the competition bidding away from government jobs. This leaves the bidding up to contractors that are geared up for long legal battles to collect the balance of payments due.

Arthur W. Peabody, Sr.
Maine Energy, Inc.
Bangor, Maine

Michigan

We are a small firm so when prime contractors do not pay us, we cannot pay our suppliers which creates a big problem when we need credit, bonding, etc. Our company personally has had trouble collecting money on time and I am sure all subcontractors have had the same problem.

Norman VanWormer
Bay Line Fire Protection, Inc.
Pinconning, Michigan

Mississippi

Eighty percent of all construction today is done by subcontractors. They buy the materials, make the payrolls and do the work. Some of the general contractors make a practice of not paying their subs for a period of 60 to 90 days. Meantime, they have been paid the money and are using it for their own purposes. This money was earned by the subs and rightfully belongs to them. Of course, the general is entitled to his mark up, but by the same token, the subcontractor is entitled to his money.

Small businesses like us are suffering because contractors are withholding payment for six months or longer. For instance, one contractor still owes Trinity Materials, Inc. for materials supplied on a job at Keesler Air Force Base over eight months ago. Another company has already been paid by the government for completion of his contract, but is more than a month behind in paying for material we provided to him.

R. Norman Bailey
Trinity Materials, Inc.
Hattiesburg, Mississippi

The problem of late payment from prime contractors on federal construction is a serious one. As you can see from the computer print out of our aged trial balances on federal construction, on 12 separate projects, my company has balances outstanding of \$44,435.74 over 30 days, \$15,610.90 over 60 days, \$52,570.14, and \$12,029.45 more than 120 days.

T.C. Morgan
Sharp Electric, Inc.
Gulfport, Mississippi

Mississippi

As you can see from the following history on a Department of Navy Project in Kings Bay, Georgia, payment has been erratic and untimely:

<u>Date</u>	<u>Invoice/ Payment</u>	<u>Current</u>	<u>Over 30 Days</u>	<u>Over 60 Days</u>	<u>Over 90 Days</u>
5/15	\$374,078	\$374,078	---	---	---
6/18	93,274	93,274	\$374,078	---	---
6/21	336,670	93,274	37,408	---	---
7/11	37,408	93,274	---	---	---
7/17	21,278	21,278	93,274	---	---
8/05	73,884	21,278	19,390	---	---
8/20	17,976	---	21,278	\$ 1,414	---
8/23	185,774	185,774	21,278	1,414	---
9/05	37	185,811	21,278	1,414	---
9/09	21,278	185,811	1,414	---	---
9/12	428,454	428,454	185,811	1,414	---
10/09	185,445	428,454	1,780	---	---
10/29	392,452	---	37,782	---	---
12/16	87,672	87,672	---	37,782	---
1/13	72,397	---	53,057	---	---
2/17	7,548	7,548	---	53,057	---
3/20	42,507	---	7,548	---	\$10,550

Without prompt pay for subcontractors legislation, it is pretty obvious that general contractors will continue to hide behind the shield of our federal government and continue with industry-wide poor payment practices.

Lawrence A. Cox
Steel Service Corporation
Jackson, Mississippi

New Mexico

We were a sub-subcontractor on a Department of Energy job. I had done business with the subcontractor with whom I contracted before and had always been paid promptly. But the general contractor on the job was from out-of-state. Pay was at least 30 days late from the very beginning of the job because the subcontractor was not being paid by the general contractor. For example, we invoiced in August for payment in September, but would not receive payment until October. We were told, "You just have to get along; this is the way it's going to be." Both the subcontractor and I contacted the general contractor but did not get an acceptable answer. The contracting officer refused to talk to us because we did not have "privity of contract". We completed our work on the job in February 1986 and submitted our request for retainage (\$5,000). The building was occupied in April 1986. I was finally paid my retainage in June 1986.

Rusty Arrighetti
The Mayhew Company
Albuquerque, New Mexico

New York

Many prime contractors use the argument that payments to subs are sometimes delayed because of poor performance. However, if full payment has not been earned by a subcontractor because of poor performance, the prime contractor should not certify the completion of such work in his billing to the government. Thus, the government, not the prime contractor, should be holding all unearned payments until they have been earned.

Floyd Warkol
Warkol Mechanical Corporation
Bronx, New York

North Carolina

The standard contract that a subcontractor signs with a prime contractor often states that the subcontractor will be paid when the prime is paid. The contract does not specify the amount of time in which the prime must pay the subcontractor after he has been paid. This leaves the door open for the prime to hold monies due the subcontractor. In the meantime, material invoices may (and generally do) become past due and begin collecting interest penalties. The burden of the interest penalties fall back to the subcontractor, not the prime. This results in loss of profits to the subcontractor.

Philip J. Samuels
All Interior Supply, Inc.
Charlotte, North Carolina

North Carolina

David Allen Company entered into a \$554,970 contract with a prime contractor for installation of our product in constructing a federal building project composed of three buildings in downtown Savannah, Georgia, owned by the General Services Administration.

For a number of months, every pay request was reduced while the prime contractor's project manager was concurrently submitting larger pay requests to GSA and falsely certifying that David Allen was being paid per the prime contractors own payments from GSA. No payment was made on the final two monthly billings. That is, the prime contractor collected funds for David Allen Company's work and retained those funds for its own purposes, including holding 10 percent retainer while GSA was withholding no retainer on the prime contractor.

The prime contractor acknowledges an outstanding balance of \$151,446 including \$9,421 interest. For a number of months we appealed in vain to GSA and the contracting officers as well as to the prime contractor. Our efforts to collect these funds, now more than ten months past due, has cost approximately \$8,000 in legal fees with no funds yet received.

Conley C. Cribb
David Allen Company
Raleigh, North Carolina

Ohio

Pedersen Insulation pays all bills for materials and services within 30 days. Labor is paid weekly. When general contractors and mechanical (prime) contractors hold up payment for 60-120 days, you can imagine the cash flow required. This is an unfair practice if the prime contractor is receiving payment in 30-45 days. The added subcontractor costs are passed on to the owner.

Deborah L. Knox
Pedersen Insulation Company
Columbus, Ohio 43230

As a small subcontractor, we have experienced slow pay from general contractors on a steady basis, particularly with regard to any Federal or State projects, to the point where it is not profitable to even bid this type of work.

David C. Frech
The Edward R. Hart Company
Canton, Ohio

Pennsylvania

Timely cash flows are critical to the survival of most subcontractors. Because we are an established and successful subcontractor, we can borrow from our bank to pay our payrolls and our suppliers when our customers delay our payments, which many do on a regular basis. Last year our average daily loan balance from our bank was approximately \$750,000 (over 10 percent of our annual sales volume) because most of our customers take more than 45 days to pay us, in spite of our contract terms. Smaller subcontractors might not survive under these conditions. Many of our customers routinely hold our payments 15 to 30 days to earn interest or pay someone else. The former controller of one of our customers even bragged how he earned enough interest each year, by delaying payments to subcontractors, to cover his annual salary. Some general contractors look at this practice as a major source of income in addition to the actual construction process.

John F. Savoy
Baeger Acoustical Company, Inc.
West Chester, Pennsylvania

Rhode Island

The following information illustrates the slow pay we are experiencing from prime contractors on federal projects. As one can see, the balances are quite large and long overdue. We must have a "prompt pay for subcontractors" bill to prevent these long overdue accounts.

Department of Defense

<u>Date</u>	<u>Invoice Payment</u>	<u>Current</u>	<u>Over 30 Days</u>	<u>Over 60 Days</u>	<u>Over 90 Days</u>
11/15	\$ 3,900	\$ 3,900	---	---	---
12/16	42,520	42,520	\$ 3,900	---	---
1/16	3,510	---	42,520	\$ 390	---
2/04	64,120	64,120	42,520	390	---
3/05	35,000	---	---	---	---
	49,020	49,020	64,120	7,910	---
2/28	35,000	49,020	37,030	---	---
3/31	7,590	56,610	37,030	---	---
4/30	21,000	---	56,610	16,030	---
5/01	17,660	17,660	56,610	16,030	---
6/03	18,300	18,300	17,660	7,590	\$65,050
6/16	6,831	18,300	17,660	7,590	58,219
6/30	15,894	---	---	---	---
	8,850	27,150	---	17,660	49,915
8/05	14,290	14,290	8,850	18,300	67,575
8/12	60,000	14,290	8,850	18,300	7,575
9/10	26,450	26,450	14,290	8,850	25,875
9/30	8,300	34,750	14,290	---	34,725
10/15	15,000	8,300	26,450	14,290	19,725
12/29	15,000	---	---	---	53,765

Environmental Protection Agency

<u>Date</u>	<u>Invoice Payment</u>	<u>Current</u>	<u>Over 30 Days</u>	<u>Over 60 Days</u>	<u>Over 90 Days</u>
1/15	\$ 846	---	---	---	---
5/23	7,250	\$ 7,250	---	---	\$ 846
9/29	3,200	3,200	---	---	8,096
10/24	10,630	13,830	---	---	8,096
11/24	21,180	21,180	\$13,830	---	8,096
12/06	6,525	21,180	10,630	\$ 3,200	1,571
12/22	31,410	52,590	---	13,830	1,571
1/12	6,000	31,410	21,180	9,401	---
1/23	11,750	11,750	31,410	21,180	9,401

Vincent J. Zarrella
Zarrella Plumbing & Heating Co., Inc.
Cranston, Rhode Island

-11-

South Carolina

In March 1986, my firm contracted with a North Carolina general contractor for additions and alterations to the Aircraft Ground Equipment Shop at Myrtle Beach Air Force Base. The following is a cash flow statement on this project.

<u>Date</u>	<u>Invoice/ Payment</u>	<u>Current</u>	<u>Over 30 Days</u>	<u>Over 60 Days</u>	<u>Over 90 Days</u>
7/25	\$ 2,866	\$ 2,866	---	---	---
8/25	32,937	32,937	\$ 2,866	---	---
8/28	2,866	32,937	---	---	---
10/7	10,000	---	22,937	---	---
11/10	10,000	---	---	\$12,937	---
12/9	2,000	---	---	---	\$10,937

You will note that, as of March 1, 1987, we were still owed \$10,937. It is my understanding that the prime contractor was paid on this project.

Sonny McDowell
Grayco Steel Corporation
Myrtle Beach, South Carolina

Tennessee

While my business is supplying materials to subcontractors, passage of S.328 would have a positive effect on my receiving payment. Similarly, the present system of payment has resulted in slow payment to me. As a specific instance, C.A. Griffis Roofing Company, of Nashville used materials furnished by me on a Department of Army job last year. The general contractor deferred payment for months . . . before paying Griffis or Griffis paying me. Non-payment on this job was a contributing factor in a decision by Griffis to discontinue his business.

Carl Hudson
Hudson & Associates
Nashville, Tennessee

Not unlike the prime contractors, subcontractors also incur expenses. Therefore, prompt payment from the prime contractor would be an asset in maintaining a steady flow of operations.

Clay Zorn
Kidd Steel
Nashville, Tennessee

Texas

In September of 1985, our firm installed approximately seven hundred feet of quarry tile at the main entrance of the Veteran's Administration Medical Center in Amarillo, Texas. Our portion of this work was completed and accepted by the job superintendent in mid-September 1985.

Our company submitted the statement for the work on September 17, 1985. We contacted the general contractor several times between September 1985 and the end of January 1986 which was in excess of 125 days. On each occasion we were told by the general contractor that he "had not yet received his payment for the job."

On approximately February 1, 1986, we learned that the general contractor had in fact received payment. Subsequently, we contacted the general contractor several more times and threatened to contact the bonding company for payment of the statement which was long past due.

In early February, after several such calls, we received full payment for work completed and accepted by the general contractor's representative in mid-September -- in excess of 150 days earlier.

Tom Yeoman
Holland Tile & Marble Company, Inc.
Amarillo, Texas

Virginia

On one job for the Department of Defense, the prime contractor delayed payment of \$12,000 to me for quite a lengthy period. When I checked with the contracting officer, I was told the prime contractor had already been paid. I finally received payment from the prime contractor 69 days later.

M.R. Sullivan, Jr.
Sullivan Mechanical Contractors, Inc.
Shenandoah, Virginia

Washington

Not being paid for extended periods of time works a great hardship on a subcontractor. Many times the prime contractors invest money on short term when it should be paid to his subcontractor.

Morris B. Mehrer
Mehrer Drywall, Inc.
Seattle, Washington



TESTIMONY OF
J. RICHARD TROLL
EXECUTIVE VICE PRESIDENT
OF THE
ASSOCIATION OF INDEPENDENT CORRUGATED CONVERTERS
BEFORE THE
COMMITTEE ON SMALL BUSINESS
UNITED STATES SENATE

FEBRUARY 25, 1987

February 25, 1987

Chairman Bumpers, Senator Weicker, members of the committee.

Thank you for this opportunity to once again appear before you and to provide our input to the legislative agenda for the Senate Committee on Small Business. My name is Richard Troll and I am Executive Vice President of the Association of Independent Corrugated Converters. I believe this is my fourth appearance before the committee and my message this time remains the same as previous appearances, except for a greater degree of urgency.

The Association of Independent Corrugated Converters (AICC) is the national trade association representing 467 of the approximate 750 independent manufacturers of corrugated shipping containers and other corrugated paper packaging products. Corrugated packaging represents the largest of all forms of packaging. Collectively the independent segment of the industry represents about 25 percent of its \$11.5 billion annual sales.

AICC's members are predominantly small to medium sized, family owned or closely held corporations, with annual sales of \$5-\$50 million. Independent companies are boxmaking, or "converting" operations only -- they own no forest lands, lumber or paper mills. They are totally dependent on the large, integrated forest products companies for their raw material -- linerboard and corrugating medium. "Linerboard" is heavy kraft paper material which comprises the inside and outside of a corrugated container. "Corrugating medium" is the fluted center part of the container. Together they are referred to as "containerboard." Most integrated companies produce both linerboard and corrugating medium. But because the major integrated paper companies also collectively operate approximately 750 box plants of their own, the independent converter must compete directly with his suppliers of raw material for the available box business. If for any reason he can't get the raw material, or if its price on the open market is such that he cannot compete, he will ultimately be forced out of business.

We are concerned about the accelerated rate of mergers, consolidations and acquisitions occurring in the forest products industry. In the past five years several large major integrated companies have purchased, merged, or have been purchased or merged with other large integrated companies. The result of all this activity has not added any significant amount of additional raw material production. Since April, 1986, however, wholesale prices for raw material have risen by about 40 percent.

In each instance of major change, our appeals for closer scrutiny by the Antitrust Division of the Department of Justice have fallen on deaf ears. We are also concerned about the unbridled concentration of mill and converting capacity in the hands of a few large companies and feel it is creating a climate for possible predatory activity.

The most recent development is the announcement of Stone Container Corporation's acquisition of Southwest Forest Industries. In combination with already owned mills and with stock ownership of Seminole Kraft in Jacksonville, Florida, this acquisition increases Stone's share of linerboard capacity to 20.22 percent of the industry total -- far greater than any other producer in the country. The largest five containerboard producers in the United States now control 50.23 percent of the total tonnage produced.

Linerboard market share is only part of the problem. I have listed below the current market share as well as box plants owned by the largest five producers of raw material.

<u>Company</u>	<u>Containerboard Market Share</u>	<u>Number of Box Plants</u>
Stone Container	20.22	91
International Paper	8.69	33
Union Camp	7.34	25
Smurfit	6.68	51
Temple Inland	7.3	27

As you can see, in addition to over 50 percent of the containerboard capacity, collectively these five companies operate a little over 30 percent of the total known integrated box companies in the country. Perhaps the most important consideration of these statistics is that all box plants -- integrated or independent -- serve about a hundred-mile radius. This means that in a given area any one of these companies operating several plants could virtually control the box market.

We call this to your attention because we feel that, left unchecked, the continuing consolidation of the forest products industry -- without the addition of new production capacity -- will create an unhealthy competitive climate for the independent box plant and equally important, the box consumer.

It is our hope that the Senate Committee on Small Business will want to consider legislation to reduce the potentially adverse effects of the laissez faire philosophy which has presided at the Department of Justice and the Federal Trade Commission over these last few years.

I will be happy to answer any questions you may have at this time and would be pleased to discuss the particulars of our concerns with members of the committee or committee staff at your convenience.

A P P E N D I X

C O N C E R N E D A L L I A N C E O F R E S P O N S I B L E E M P L O Y E R S

TESTIMONY OF
CYNTHIA GRANTZ
PRESIDENT AND CHAIRMAN OF THE BOARD
ROCKFORD COATINGS CORPORATION
ROCKFORD, ILLINOIS

ON BEHALF OF
THE CONCERNED ALLIANCE OF RESPONSIBLE EMPLOYERS
BEFORE THE HOUSE SUBCOMMITTEE
ON LABOR-MANAGEMENT RELATIONS

FEBRUARY 25, 1987

CONCERNED ALLIANCE OF RESPONSIBLE EMPLOYERS

Mr. Chairman and members of the subcommittee, I am Cynthia Grantz, president and chairman of the board of Rockford Coatings Corporation, a manufacturing firm in Rockford, Illinois, which employs 89 people. I am testifying today on behalf of the Concerned Alliance of Responsible Employers, CARE; the National Association of Manufacturers; and the National Federation of Independent Business. CARE is a coalition of 140 organizations, which is actively seeking to preserve the voluntary system of benefit structuring which allows employees and employers to determine which benefits are best suited for their individual and mutual needs. Overall, CARE's members directly represent a wide range of businesses and professionals, including manufacturing and service sectors, wholesaler-distributors, the food and restaurant industry, personnel administrators and hundreds of thousands of small to mid-size firms across the country.

The National Association of Manufacturers (NAM) is an organization of 13,500 corporations -- 80 percent of which are small business -- located in every state and involved in the spectrum of manufacturing enterprises. NAM members employ 85 percent of the nation's industrial workers and produce more than 80 percent of the nation's manufactured goods. NAM is affiliated

with an additional 158,000 businesses through its Associations Council and the National Industrial Council.

The National Federation of Independent Businesses (NFIB) is the nation's largest small-business organization, representing more than 500,000 small and independent enterprises. NFIB's legislative positions are set through membership polling; eight out of ten NFIB members oppose mandated parental leaves.

On behalf of all the members of CARE, NAM and NFIB, I would like to thank you for this opportunity to express our opinion on federally mandated family leave policies.

I. Introduction

CARE's member organizations strongly support company programs to assist workers in meeting their dual work-family responsibilities, and encourage employers to seek innovative solutions to problems working parents encounter. CARE recognizes that the retention of experienced, trained workers is important to compete effectively in a global marketplace and encourages employers to explore all avenues of change and accommodation to that end. CARE believes the private sector is best equipped and provides the most flexible and efficient response to the changing demands and requirements of its workforce, and encourages Congress to protect the voluntary, private enterprise system which allows maximum latitude for both employees and employers.

As more workers with family responsibilities enter the workforce, companies have implemented programs designed to assist workers in meeting their dual work-family responsibilities. Among such programs are (1) alternative work schedules including flextime, voluntarily reduced workweeks, job-sharing and part-time employment; (2) child and dependent care programs such as on-site or near-site day care, day care subsidies and child care vouchers; (3) employee assistance programs; (4) flexible benefit plans, cafeteria-style benefit plans which allow workers to choose those benefits most suited to their particular needs; (5) family leave policies; and (6) information and referral programs.

The types and feasibility of such programs differ for each employer, based on a variety of factors such as the type of industry, size and skill of the workforce, individual workforce needs, competing standards in the industry and the ability to assume costs.

For example, small employers typically institute vacation and sick leave benefits first. Then, as their profitability increases, health insurance is the next most widely offered -- and desired -- benefit. Yet, the number one problem for small employers, according to an NFIB survey, is the cost of health insurance. Legislating new benefits and requiring benefit coverage at employer cost during extended leave periods will only exacerbate this problem. In August, the White House Conference on Small Business selected mandated benefits as the number two priority issue, second only to liability insurance. Small

businesses expand benefit coverage as their profitability increases; nowhere is this fact recognized in this legislation.

CARE opposes legislation that would mandate across-the-board requirements that ignore the very real differences among businesses, their workforces and changing economic and business climates. The family and medical leave bills, H.R. 925 and H.R. 284, would seriously undermine many business operations, particularly smaller concerns that may find it impossible to hold open a position for the leave periods mandated in these bills. The legislation would result in additional costs and hamper productivity. As a consequence, businesses may be forced to scale back or drop other needed and desired benefits. Without a doubt, this legislation will severely limit this country's greatest job generators -- small business.

The major share, 70 to 80 percent, of all new job creation in this nation today comes from the small-business sector. At a time when the President and Congress have widely acknowledged that our nation is teetering on the brink of losing its competitiveness, to place additional requirements such as mandated family leave upon business is unimaginable and most certainly unwise. European economies burdened with mandated benefits are generating fewer jobs, have higher levels and longer periods of unemployment and typically boost their productivity by adding more capital rather than labor.

Family leave policies are excellent benefits but an extended leave policy is only one benefit option among many that can be instituted to help workers with their family responsibilities. Benefits and policies to help working families are important to employers because they are becoming increasingly important to their workforces. They are valuable recruitment and retention tools, and as the workplace evolves, more and more employers will formally implement work-family policies.

II. Effects of Legislation.

Companies today are faced, as never before, with the challenge of improving productivity and controlling costs. The costs that would be incurred with this legislation are not consistent with the emphasis Congress is placing on competitiveness and economic growth.

Because the leave periods stipulated in these bills are unpaid, a casual analysis would lead one to believe these bills are cost-free. Nothing could be further from the truth. One of the obvious costs of the proposal is in advertising for, obtaining and training replacement personnel for those employees on leave. Even large companies are segmented into small work groups where the absence of as few as one or two employees could critically affect the group's performance.

Replacing employees for a leave period is often inefficient because there is not enough time available for adequate training

and consequently the work performance is substandard. If an employee cannot be found or it is impracticable to hire a replacement, the additional workload must be assumed by coworkers and overtime costs are incurred. In the case of highly specialized positions, temporary replacements may be impossible to find.

In addition, there are other costs such as unemployment insurance taxation. As employers are forced to dismiss temporary employees when the regular employee returns to work, unemployment taxation costs will increase. In fact, in all but 14 states, an employee working the temporary family leave period would be eligible for unemployment insurance based solely on an 18 week period.

In this debate, attention has been drawn to a comparison of family policies among industrialized nations, and much has been made of the lack of policy in the United States. The whole picture must be examined prior to making hasty judgements.

Consider that pay and benefits for American workers are among the highest in the world and the U.S. continues to be a marvel of job creation, particularly in the small business sector. European countries, on the other hand, have had no net job creation since 1975, and unemployment continues in the double digit range.

Across-the-board mandates are based on erroneous assumptions. In fact, (1) all businesses are not alike (2) economic and business climates are not stable (3) all employee needs are not the same

(4) and the costs of mandated family leaves will limit the availability of other benefits.

Congress is attempting to micro-manage the nation's businesses, while refusing to accept the burdens of inflexibility itself. Employers need the flexibility to tailor benefit and wages to market demands and individual workforces. In any event, the most important employee benefit is a paycheck. For example, a Massachusetts bank recently tried to attract employees with a generous benefit package. The effort failed. Trying another tactic, the bank then costed out the benefits and increased the wages offered. They were inundated with applicants!

III. Rockford Coatings Corporation.

I am president and chairman of the board of Rockford Coatings Corporation, a family business founded by my late husband's grandfather in 1906. The company manufactures industrial paints and coatings for manufacturers of primarily metal products, such as lawn and garden equipment, metal shelving, furniture and fixtures and aluminum extrusions. We are a job shop in that each formula is developed to customer specifications and all our paint is manufactured per customer order. The company operates plants in Rockford, Illinois and St. Louis, Missouri.

Paint has become highly technical in recent years, not only because of the demand for improved quality and performance, but also because of EPA regulations for solvent reductions in the

workplace and the on-going culling out of suspected health hazards in chemical products. The paint we make goes directly on our customer's line and is an integral part of his manufacturing process. Because of this, there is great demand for continual technical service. Rockford Coatings' particular strength is in its ability to both respond quickly to customer line emergencies and meet the short lead-times required by just-in-time deliveries.

Everyone knows well the lament of American manufacturers today. It is tough. Price increases are frequently impossible and price reductions are often demanded. We have had to swallow whole much of the massive insurance increases which, as you might image, are substantial in a chemically related business. And, in addition, we are in a Superfund site where we are participating in what I understand is the first voluntary clean-up in the country. Last fiscal year alone this cost us five percent of gross sales, and I would add that this figure represents not only our own purported share, but also a portion of the shares for those companies no longer in business or solvent.

We employ 89 people company-wide which is a net increase of five in the last two years. The company provides group life and medical insurance for which it contributes 80 percent of the premium; both short- and long-term disability coverage; and a new 401(K) plan at the request of our employees. As a result, we terminated a defined benefit plan. This plan is not only fully funded, but we elected to distribute the company portion to our

employees. We have given salary and wage increases every year since 1958. We have had one strike in our 80-year history but not one lay-off.

The company encourages long-term employment and makes every effort to accomodate the special needs of its employees when problems occur. The flexibility needed to make these accomodations would be limited if government were to begin mandating benefits such as leave.

I first learned of the family and medical leave legislation about one month before the White House Conference on Small Business to which I was a delegate. It took many of us by surprise, at least in the Midwest, but I think it is significant that "no mandated benefits" emerged as the second most important issue to that Small Business Conference in its final recommendations to the Congress.

I am opposed to the legislation, not because of its intent or the issues it addresses, but because it would give to government rather than to employers the right to construct the appropriate benefit packages. If it were to pass, it would have severe consequences for Rockford Coatings because it would require leaves of such a nature and length that it would threaten the stability of our business. If the legislation were in effect today, paternity leave alone would cost our company four months' service of 10 percent of our technical force, including our Rockford lab manager. Paint chemists and service technicians are

not available in the temporary market. We would have to choose between overburdening other employees or violating an unreasonable law by denying the leave or hiring replacements. Surely, lawsuits would be inevitable, productivity would suffer and the costs would be grave.

I would like to add one final word about Rockford which is the second largest city in Illinois and the city most dependent on a manufacturing base.

Rockford has had a net loss of 8500 jobs since 1979. According to the Rockford Chamber of Commerce, we have 700 manufacturing firms in the Rockford area, 600 of which -- like us -- employ fewer than 100 people. According to the State of Illinois, manufacturing jobs account for 38 percent of Rockford's labor force, but when manufacturing support jobs are added, that figure increases to 51 percent. Small manufacturing is essential to our community and must be maintained.

In conclusion, I would only add that a good business has responsibility to its customers, employers, suppliers and stockholders. The private sector must be free to meet these responsibilities and keep them in balance. I would urge the Congress to permit us to do so.

STATEMENT OF CLOVIS HAUBEIN
LEGISLATIVE COMMITTEE CHAIRMAN
NATIONAL FARM AND POWER EQUIPMENT DEALERS ASSOCIATION
BEFORE THE SMALL BUSINESS COMMITTEE
UNITED STATES SENATE
WASHINGTON D.C.
FEBRUARY 25, 1987

Mr. Chairman and members of the committee, my name is Clovis Haubein and I am a farm implement dealer from Lockwood, Missouri as well as Chairman of the Legislative Committee of the National Farm and Power Equipment Dealers Association (NFPEDA) which is headquartered in St. Louis, Missouri. NFPEDA represents more than 7,000 agricultural and industrial equipment dealers throughout the United States. The historic membership base of the Association has been in the farm equipment business and it is our members who sell and service the equipment which runs our nation's farms. We handle equipment manufactured by all of the big names in the business including Case International, Deutz-Allis, Massey-Ferguson, Ford and John Deere. We also handle hundreds of other lines of which you may not have heard.

In addition to farm equipment, many of our members are heavily involved in selling and leasing industrial equipment. Their customers are construction industry contractors including road, home, and commercial builders and many businesses which use equipment such as forklifts in their daily operations. As suburbs have spread into formerly rural areas, many of our members have also increased their business in the outdoor power area, selling lawn and garden equipment to homeowners.

The vast majority of our members are small businessmen and

women by any definition of that term. Approximately three out of every four dealerships is owned either by a family corporation or a single individual. Almost half of all dealerships are being operated by the second, third or even fourth generation of a family. More than four out of every five dealerships are single store businesses.

We appreciate this opportunity to comment on the important topic of developing legislative priorities for the 100th Congress. Like many small businesses, our members are beset by a wide range of problems - some of a marketplace origin which are not amenable to a governmental solution and others which are the result of misguided or half-hearted government intervention. We believe it is important for the small business community to band together to attack those problems which are of general concern and for which there is a readily identifiable solution at hand.

To that end, NFPEDA has just completed a legislative priorities survey of the leaders in our industry from every region in the country. Participants were asked to review the list of 60 issues identified by the White House Conference on Small Business and to select the 5 issues which they believed to be of the most concern for equipment dealers. It may come as no surprise to the committee that the issue ranked first by the 1986 Conference - tort reform - was overwhelmingly selected by our members as the most important issue which should be addressed by the 100th Congress.

Specifically, the issue was framed in these terms: "Enact sweeping reforms affecting liability insurance in four areas:

return to a fault-based standard of liability; restrict joint and several liability; limit noneconomic (pain and suffering) damages; and restrict punitive damage awards. Also, enact uniform federal standards for product, professional and commercial liability." Despite the current lull in public and congressional attention to this issue, our members clearly believe that fundamental reforms to a tort system that has gotten out of hand are essential to provide a stable legal foundation for their businesses.

Recognizing that the fiscal health of the government has a direct relationship to the general business climate, the second priority of our members is to bring the federal budget deficit under control. Included in this category of necessary congressional actions are: fixing the constitutional flaw in the Gramm/Rudman/Hollings balanced budget act and adhering to its goals; passing a balanced budget amendment to the Constitution; giving the President line-item veto authority; and enacting the Grace Commission's budget-cutting recommendations.

The third area of concern for equipment dealers is of a defensive nature - prevent government-mandated employee benefits, such as employer-paid health benefits, parental leave and disability leave, from being imposed on all small businesses regardless of their appropriateness for a specific business or work force. Maintaining the flexibility to structure compensation packages and fill staff vacancies in accordance with the business demands and financial resources of the equipment dealership is vital to our members.

The legislative issue which ranked fourth in the NFPEDA survey involves repealing a recent "reform" which our members believe was misguided - repeal of the investment tax credit. Equipment dealers would like the 100th Congress to reinstate the ITC, at least for new and used equipment for businesses with fewer than 500 employees. Farm equipment dealers believe that they will be hit especially hard by this tax law change. Coming on the heels of a six year depression in the agricultural economy, loss of the ITC for farm equipment purchases is a real double whammy. Several thousand farm equipment dealers have gone out of business during this period, weakening the economies of many communities and causing the loss of thousands of jobs, and the trend shows no sign of reversal. If there was ever a period in American agriculture which justified a tax stimulus to the economy of rural communities, it is now.

Finally, the equipment dealers would like to see the 100th Congress toughen federal bankruptcy laws. As retailers, many of our members have borne a real burden as the number of farm bankruptcies continues to increase. While we certainly have empathy for our farmer customers who are in financial trouble, common sense dictates that business decisions be based on financial reality and that bankruptcies be handled with dispatch.

Recently enacted legislation which created a new Chapter 12 bankruptcy proceeding for farmers is of particular concern to equipment dealers. This new law permits family farmers to write off secured debt in excess of the market value of the asset. In the case of rapidly depreciating farm equipment, this will mean

inadequate protection of loan security for equipment dealers. Early indications are that the law is being abused as overly eager attorneys are encouraging their clients to aggressively write down their debt. NFPEDA believes that this law must be closely monitored and the necessary steps taken to insure that the farm bankruptcy burden is not shifted unfairly to equipment dealers.

Again, thank you very much for the opportunity to share the concerns of equipment dealers with the committee. I would be most happy to answer any additional questions which the committee might have.



National Association of Solvent Recyclers
1333 New Hampshire Avenue, N.W. Suite 1100
Washington, D.C. 20036 202/463-6956

February 25, 1987

Senator Dale Bumpers
Chairman, Committee on
Small Business
Room 428A
Russell Senate Office Bldg.
Washington, D.C. 20510

Attention: Tracy Crowley, Hearing Clerk

Dear Senator Bumpers:

The National Association of Solvent Recyclers (NASR) represents over 50 independent solvent recycling companies nationwide whose primary business is the reclamation of pure solvents from used solvent streams. Our members service waste generators as large as General Motors and as small as the neighborhood auto body shop. They provide the chemical engineering expertise and specialized equipment needed for the safe and efficient management of solvent wastes.

Whenever a solvent is used as a wash, degreaser, dry cleaning agent or paint remover, impurities contaminate the product. The recycling process simply separates the solvent from these impurities so that it can be brought up to specifications and reused. Most of the solvent can be reused repeatedly. The remaining material (often around 10 percent by volume) has a high Btu content and is suitable for use in fuel blends. Recovery rates approaching 95-100 percent are not uncommon.

Solvent recycling is a key component of the national waste minimization strategy prescribed by the 1984 amendments to the Resource Conservation and Recovery Act (RCRA). The amendments require the reduction of volume and toxicity of hazardous wastes, as an alternative to continued landfilling that often causes air and water contamination. They also led to the Environmental Protection Agency (EPA) ban on the land disposal of solvent wastes as of November 8, 1986. In addition, small quantity generators (SQG) have come under the

cradle-to-grave RCRA regulations. These factors contribute to the continually growing demand for solvent recycling capacity. According to EPA's October 1986 report to Congress, entitled "Minimization of Hazardous Waste," offsite recycling accounted for the treatment of 65 percent of hazardous wastes generated by SQGs in 1984. The percentage has surely increased since then due to regulatory developments.

Solvent recyclers not only offer safe, legal and expert management of solvent wastes from SQGs, but also act as consultants to these small businesses in the handling of waste and compliance with state and federal regulations. Yet, despite the efficiency of solvent recycling; despite the importance of solvent recycling to the national policy of waste minimization; and despite the growing dependence of small businesses and larger companies upon the specialized services of solvent recyclers, the RCRA insurance amendments and EPA's implementation of those amendments threaten our members with closure. According to a memo issued by EPA Assistant Administrator J. Winston Porter on October 29, 1986, if a hazardous waste treatment facility cannot obtain environmental impairment liability (EIL) insurance, EPA Regional Offices must force the facility to close.

Under RCRA, solvent recyclers as hazardous waste treatment facilities are required to carry \$1 million of insurance for sudden and accidental releases with an annual aggregate of \$2 million. Unless a company has a tangible net worth of \$10 million, this insurance coverage is mandatory in order to legally operate. NASR members have no objections to carrying liability insurance; as a matter of sound business practice they would choose to have EIL coverage. But in recent years their policies have been cancelled; their premiums have risen up to ten times; their exclusions have increased; and a single insurance company, National Union Fire Insurance, continues to write EIL policies when they are available at all. The market has become so constrained that fully half of NASR's members can expect to lose their insurance in the coming year. This is a particular problem for small companies such as ours that cannot offer large deductibles and large premium income to the underwriters who write this risk.

Insurance companies have not denied our members EIL coverage because they fail to meet safety standards, fall out of compliance with environmental regulations, or represent bad risks in and of themselves. The basis for the collapse in this insurance market is the standard of strict, joint and several liability under Superfund and RCRA. This standard makes it

virtually impossible to rate the risk of insuring our members because they may at any time be held responsible for the acts of other companies. For example, if a company contributed waste to a landfill that required cleanup under Superfund, it could be held liable for the entire cost of cleanup regardless of the company's compliance with government regulations, percentage of waste contributed to the site, or negligence. The unpredictability of the claims made against EIL policies under this scheme has caused insurers to withdraw from the market. According to David Rosenberg, Executive Vice President of an insurance underwriting firm specializing in programs for hazardous waste treatment companies, "we see no changes in the cost or availability of insurance within our industry."

NASR recognized the serious nature of the insurance crisis over two years ago. The association formed an Insurance Committee and began devoting increasingly large segments of the annual Spring and Fall Meetings to learning more about insurance alternatives and ways to cope with the situation. Most of our members were too small to provide the capital needed to finance an insurance captive, and so they continued seeking new sources of coverage and began setting aside contingency funds as a form of self-insurance. Some have paid premiums as high as \$500,000 for \$1 million in coverage for one year, drastically increasing their operating costs and making them question if their profits justify remaining in business.

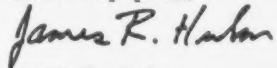
There is no logic to the predicament of solvent recyclers. Their services have never been in greater demand nor more environmentally sound. Yet many of them will not operate ten years from now, and few entrepreneurs can be expected to venture into the solvent recycling industry for the first time. Should this industry all but disappear, it will mean not only the loss of 50 small businesses, but damage to countless other small businesses that depend upon their knowledge and services. Some generators will have to transport used solvents far greater distances to reach the few facilities that survive. Others will resort to less efficient disposal methods, such as incineration. Perhaps most important, the experience, commitment, and integrity of an entire generation of businessmen will have been squandered.

Congressional committees with jurisdiction over hazardous waste issues must find ways to fund cleanups and control the vast chemical industry. It is not their primary, or even secondary, objective to see that companies that recycle waste can survive. It is because of those priorities that they have failed to recognize how their well-intentioned efforts have imperiled, ironically, a vital contributor to the success of our national waste minimization policy.

NASR's members turn to the Small Business Committee because you can approach our concerns from a unique perspective. Only you can set out with the express objective of preserving the small businesses that comprise NASR. It is our hope that we can work with you to develop solutions to our problems. We believe there is an answer to the liability insurance crisis. At the very least, there must be a way to enable our members to avoid the Catch-22 created by the Federal government - namely that you must have insurance to operate, and yet the legal regime created by Congress has virtually eliminated the pollution liability market.

We believe there are serious competitive implications in this dilemma and we urge your Committee to hold hearings on this issue to determine ways in which relief could be provided by Congress. We would welcome the opportunity to actively participate in such a forum and to offer our recommendations.

Sincerely yours



James R. Hulm
President

STATEMENT OF
JOHN D. ABERNATHY
CHAIRMAN AND CHIEF EXECUTIVE PARTNER
SEIDMAN & SEIDMAN/BDO

MARCH 16, 1987

On behalf of my firm and myself, I appreciate the opportunity to offer our views on how Congress can prioritize and address some of the problems facing smaller business. My name is John D. Abernathy, and I am the chairman and chief executive partner of Seidman & Seidman/SOO which is a national accounting firm offering accounting, tax and consulting services to emerging and mid-sized businesses throughout the country. Seidman & Seidman/SOO is 77 years old and throughout our history we have served the market under your consideration. Based on our experience, we are pleased to share our thoughts in the hope that they will lead to improving the environment for small businesses, which fuel the growth of our economy by creating jobs and fostering innovation.

Last summer, the White House Conference on Small Business named as its number one issue the liability crisis, and the Conference urged a four pronged effort for reform. Like the representatives of the Conference, I would like to urge your committee to consider this area as a priority for remedial action.

While the current insurance availability crunch, felt acutely last year, has abated, we should not be deceived that the insurance problem is over. We continue to see large increases in the cost of insurance coverage among our clients

and know that the root causes of the problems with insurance availability and affordability continue to exist and need to be addressed.

According to recent studies by The Rand Corporation, the 1985 expenditure nationwide for tort litigation terminated in state and federal courts of general jurisdiction ranged between \$27 billion and \$34 billion. This amount, for 866,000 tort lawsuits, includes:

- compensation paid to plaintiffs
- legal fees and related expenses for both plaintiffs
and defendants
- insurance company costs in processing claims
- value of litigants' time, and
- the cost of operating the court system for these cases.

Put another way, the Gross National Product of Greece, was approximately equal to what the U.S. spent in one year of court settlements. This would be laughable if the impact on business and society weren't so damaging.

The core of the tort problem falls in the area known as the "new litigation." Personal injury, primarily auto cases, remains a stable area of law. There is high volume, but modest

stakes and no dramatic changes evidenced or expected. But in the areas of "new litigation," like product liability and malpractice or mass toxic (latent injury), there are increasingly large stakes due to increasingly larger awards.

Although the latter constitutes a small fraction of the number of cases, it represents a major share of the total dollars awarded at the trial court level. And the number of complex cases where large awards are at stake appears to be growing more rapidly than tort liability cases overall. Furthermore, the "tail" of large awards is mounting as are the costs of the litigation itself.

I am sure that each of you has read and analyzed the numerous papers and studies which have shown how the country has moved away from a fault-based standard of liability to a view that attempts to redress injury by assessing damages wherever the "deep pockets" can be found, even if that company is only remotely connected to the problem which caused the damage or injury. While the amounts awarded in smaller routine cases have remained fairly constant, the number of cases involving complex, unfamiliar issues and large stakes is increasing rapidly and constitutes the largest proportion of dollars awarded at the trial court level. Most state courts do not tabulate cases by type, but "In federal courts alone, product liability actions

from 1974 to 1985 increased from 1,579 to 13,554 -- a 758% rise..." (Forbes, Aug. 11, 1986, p. 79).

The Tort Policy Working Group, an interagency group established by the Attorney General in October of 1985, released its findings in February of 1986. In this report (entitled "Report of the Tort Policy Working Group on the Causes, Extent and Policy Implications of the Current Crisis in Insurance Availability and Affordability") the Group mentions: "The excesses of the tort system, however, present a very real opportunity to address a major cause of the insurance crisis with sensible and appropriate reforms." Number one on the list of reforms was the return to a fault-based system for liability. In non-product liability cases, the Report urged that negligence remain as the applicable standard of liability. The Report suggested that a consistent product liability standard be defined clearly. This will again link cause to liability and clear the currently muddled waters.

The handmaiden to a fault-based standard is proportionate liability. The significant area in need of reform in federal and state cases involving negligence is the replacement of the prevailing rule of "joint and several" liability with "several" liability alone. Currently, in most jurisdictions, a claimant

can collect all or part of his damages from any defendant found liable, irrespective of that defendant's proportionate fault. While many states have adopted comparative negligence laws that provide for liability apportionment based on the parties' relative degrees of fault, all but a few continue to maintain the rule of "joint and several liability."

An evaluation of comparative fault is meaningless if a minor tortfeasor must bear the cost of all damages. If a joint and several rule is replaced with a "several" liability rule, a defendant would not be compelled to pay more than its proportionate share of the claimant's loss.

While tort reform must come from many levels, I urge you, on behalf of small business, to take action in the areas that involve the federal government.

Capping non-economic damages is another area for your consideration. To illustrate the benefits derived from this approach, I point to another Rand Study by Patricia Danzon, published in March 1986 entitled "The Effects of Tort Reforms on the Frequency and Severity of Medical Malpractice Claims: A Summary of Research Results." While this report studied only medical malpractice litigation, its conclusions are useful in predicting the potential effects of capping non-economic damages.

While we must be careful in this sensitive area, to permit grievances to be adequately compensated, Ms. Danzon's study yields information that sheds light on the potential impact of caps. She examined states which had placed a "cap" on verdicts, or eliminated specific dollar requests by plaintiffs, or permitted awards payments in installments.

The seeming effects of such reforms were: 1) A reduction in the average "shadow verdict" by 30%, 2) A decrease in the average settlement of 25%, 3) An increase in the number of cases dropped from 43% to 48%, and 4) A decrease in the number of cases going to verdict from 5.1% to 4.6%.

It should also be noted that the amount which litigants either win or pay out is contingent not only on the injury but also on who is the defendant and plaintiff. On the whole, businesses paid one-and-a-half times more than individuals and corporate defendants paid two-and-a-half times more than individuals.

Ms. Danzon said it was not yet possible to estimate accurately the cumulative effect of caps, but the study indicated that caps do have an important impact. She also found that reducing the statute of limitations and those statutes mandating the offset of collateral benefits, reduced the

frequency and severity of the claims. I urge you to consider the benefits of each of these approaches, with respect to fairness to injured parties as well as in fairness to the business community.

The issue of contingent fees is another sensitive area. Contingent fees permit access to the courts by those who otherwise would not be able to pay for the long and expensive legal battles needed in liability cases. On the other hand, contingent fees are funneling major portions of the settlements to lawyers, rather than the injured parties. The cost of legal fees relative to settlements is substantial. Out of the previously cited \$27 billion to \$34 billion total expenditure for tort litigation, an estimated \$14 billion to \$19 billion was spent for the various costs of the tort litigation system. According to testimony before the Joint Economic Committee of the U. S. Congress in July of 1986 by James Kakalik and Nicholas Pace, who researched the subject for the Institute for Civil Justice of the Rand Corporation, these costs break down as follows: Defendants' total costs for tort litigation, terminated in courts of general jurisdiction in the U.S. in 1985, were an estimated \$8 billion to \$10 billion, including \$4.7 billion to \$5.7 billion for legal fees and related expenses, \$0.8 billion for insurance company costs of processing claims in suit and \$2.5 billion to \$3.5 billion in the value of defendants' non-lawyer time and other expenses.

TABLE S.1*

DEFENDANTS' COSTS OF TORT LITIGATION TERMINATED
IN STATE AND FEDERAL COURTS OF GENERAL
JURISDICTION IN 1985
(In \$ billion)

Type of Cost	Estimate 1, Primarily Based on Insurance Industry Data	Estimate 2, Primarily Based on Lawsuit Survey Data
Defendants' legal fees and expenses	4.7	5.7
Claims-processing cost for lawsuits	0.8	0.8
Value of defendants' time and other expenses	2.5	3.5
TOTAL	8.0	10.0

Plaintiffs' costs are estimated at \$5.8 billion to \$7.2 billion
in legal fees and expenses:

Table S.2*

PLAINTIFFS' COSTS OF TORT LITIGATION
TERMINATED IN STATE AND FEDERAL COURTS OF
GENERAL JURISDICTION IN 1985

(\$ billion)

Type of Cost	Rand Estimate 1 Primarily based on Insurance Industry Data	Rand Estimate 2 Primarily based on Lawsuit Survey Data
Plaintiffs' legal fees and expenses	5.8	7.2
Value of plaintiffs' time and other expenses	0.7	1.1
TOTAL	6.5	8.3

- * Tables S.1 and S.2 are taken from "Costs and Compensation Paid in Tort Litigation" by James S. Kakalik and Nicholas M. Pace, published by the Rand Corporation 1986.

In the previously cited study on medical malpractice claims by Ms. Danzon, she found that when contingent fees charged by plaintiffs' attorneys were limited: 1) The average settlement was cut by 9%, 2) The portion of cases dropped went from 43% to 48%, and 3) The share of cases going to verdict went from 6.1% to 4.6%. While Ms. Danzon's study only considers claims of medical malpractice and cannot be considered definitive, it shows strong evidence that limiting contingent fees has a beneficial effect on the cost of liability cases. Since these fees are part of the fabric of the business economy and the cost of doing business, we can extrapolate that reduced contingent fees would be another reduced business expense. At the same time, we are mindful that despite the economic impact of settlements, we must be certain not to inhibit access to the justice system.

The liability problem and our escalating costs represent a serious effort in our society to grapple with a basic question: should we have a broad policy of compensation, or should compensation be paid only when fault is directly attributable? We strive to be a humane and just society. But a flawed system is evolving.

In addition to the issues of fault and proportionate liability, we support the White House Conference's recommendation that alternatives to court litigation should be explored. (Recommendation No. 8, p. 74 of Report). Such alternative proposals range from binding arbitration to mediation and include such innovations as mini-trials and expedited discovery techniques.

Similarly, we back the White House Conference suggestions on business access to insurance. Innovative ways to provide insurance need to be explored and acted upon in concert with tort reform. We have all seen and experienced the social and economic problems that have recently resulted when our existing sources for insurance dried up or became prohibitively expensive.

We need to be creative and devise alternatives to traditional methods. This is particularly needed in the area of small business, the group that is most hurt when insurance becomes unavailable or prohibitively expensive. While a large business may be able to reduce dividends or capital investment in a time of insurance availability crisis, a small business, without such flexibility, may see the existence of the business itself threatened. Ski resorts, day care centers and numerous other businesses that are family owned, or run by

entrepreneurs, were pushed to the brink--or over it--during the last crisis.

A self-insurance system for small businesses, or risk pooling and other group arrangements are worth exploring as viable alternative arrangements for small and mid-sized businesses who need a lifeline to insurance.

Similarly, we support an increase in the notification period to businesses before non-renewal of a policy or an increase in premiums of more than 25%. We feel that the 60-day minimum recommended by the White House Conference is a good start. But an even longer period would better enable businesses to find additional avenues for coverage. In addition to the number one recommendation of the White House Conference, which urges Congress to take a multi-faceted approach to the insurance availability and affordability crisis, we also recommend that Congress focus on several tax areas which would provide relief to small businesses.

First, the Investment Tax Credit should be retained or restored for new and used equipment for small business, but should be limited to end users of property purchased to aid domestically produced products (#16, White House Conference Report). On February 6, 1986, Seidman's National Director of

Taxation, Mario P. Borini, testified before this committee in defense of this concept. At that time, Mr. Borini said, "Competition with foreign imports from low labor cost countries is already difficult enough without increasing U.S. capital costs even more through elimination of the tax incentives." He also suggested that some type of jobs tax credit be considered to aid the small service businesses which cannot benefit from the investment credit.

Secondly, Seidman supports Recommendation # 20(c), which would increase the contribution benefit of 401(k) plans and IRA's, or as the Internal Revenue Code refers to them Cash or Deferred Arrangements (CODA's). Realistically, many small businesses owners cannot afford to adopt more traditional retirement plans for their employees, much as they would like to. By adopting CODA's, employees in small businesses can set aside meaningful savings for their retirement rather than the token amount presently allowed for IRA's.

Making CODA's less attractive will only penalize employees of small businesses. Increasing the contributions under CODA's allows owners of small businesses to provide benefits that they could not otherwise afford.

Finally, we express our support for Recommendation #22, which suggests that all small businesses be allowed to use the cash method of accounting for tax purposes.

This method of accounting recognizes items of income and expense based on the taxable year in which funds are received or disbursed. While we recognize that the cash method is not in accordance with generally accepted accounting principles (GAAP), it is a simpler and more equitable method of taxation for small business. We would like to see the cash method extended to more taxpayers. Its simplicity will encourage better compliance with the tax system by smaller businesses, thereby easing administration. And any revenue shortfall resulting from income deferral under the cash method would likely be recouped in the following year.

Small and mid-sized businesses need the attention and concern of legislators. The White House Recommendations offer Congress an agenda of areas to focus and act on, to help small business stay vital. On behalf of Seidman & Seidman/BDO, I urge you to energetically support and act on these issues this year.

WRITTEN STATEMENT
OF
THE SYNTHETIC ORGANIC CHEMICAL MANUFACTURERS ASSOCIATION
BEFORE THE
SUBCOMMITTEE ON LABOR
COMMITTEE ON LABOR AND HUMAN RESOURCES
UNITED STATES SENATE
ON
S. 79,
THE HIGH RISK
OCCUPATIONAL DISEASE NOTIFICATION
AND PREVENTION ACT
OF 1987

March 5, 1987

The Synthetic Organic Chemical Manufacturers Association ("SOCMA") appreciates this opportunity to provide testimony for the record on S. 75, the High Risk Occupational Disease Notification and Prevention Act of 1987. SOCMA is a non-profit trade association with approximately 100 members. Many of SOCMA's member firms are small businesses with annual organic chemical sales below \$10 million.¹ SOCMA's members produce a wide variety of synthetic organic chemical products which are essential to virtually every other major chemical industry and are responsible for much of the innovation in the industry today.

SOCMA strongly recognizes the right of an employee to be informed of his exposure to hazardous substances. This is a basic right of the employee and the responsibility of the employer. For example, SOCMA supported the development of the OSHA hazard communication standard. Pursuant to the hazard communication standard, SOCMA's member companies provide notification to employees about the risks associated with

¹ SOCMA's significant small business membership is representative of the organic chemical industry as a whole. The Small Business Administration's data show that 40% of firms in the industrial organic chemicals industry, SIC Code 2800, are percent owned (have more than 50 percent

exposure to potentially hazardous substances through training, labeling, and material safety data sheets.

However, SOOMA is concerned that the legislation as currently drafted may have significant adverse impacts on its member companies, particularly the small business segment, and on their employees. In particular, SOOMA believes that S. 79 may: (1) cause an increase in the cost of, or the outright elimination of, health, life, and worker compensation insurance available to employers with workers identified in "at risk" categories; (2) increase employer's exposure to liability claims based on limited or unsubstantiated data, and therefore effect the cost and availability of workers' compensation and liability insurance; and (3) impose significant costs of medical surveillance in circumstances where it is unwarranted. These impacts could cause small businesses to lose their ability to attract employees and to price products competitively with larger companies. Some small businesses may be forced to alter their product lines or to close altogether.

These concerns of small business are particularly acute in the context of S. 79 because substantial over-notification to employees not actually "at risk" could occur. The proposed risk assessment board to be established within the Department of Health and Human Services would not be required to adhere to rigorous development of scientifically-defensible conclusions. Over-notification could

impose unwarranted anxiety and other impacts on the notified employees and unwarranted burdens on the employer, without any offsetting benefit to public health.

I. OVER-NOTIFICATION TO EMPLOYEES NOT ACTUALLY AT SIGNIFICANT RISK

S. 79 as currently drafted likely would result in over-notification to employees not actually facing a significant increased risk. Under the broad notification criteria in S. 79, many employees would be designated as at risk who would otherwise be excluded if the determination were based upon sound science and principles associated with a well-conducted risk evaluation.

Specifically, Section 3(7) of S. 79 defines an "occupational health hazard" as a substance "for which there is statistically significant evidence (based on at least one study conducted in accordance with established scientific principles) that acute or chronic health effects may occur in exposed employees." This definition is based on the OSHA hazard communication standard, 29 C.F.R. § 1910.1200(c), which was designed to be a "broad approach" that would require employers to "evaluate and communicate information concerning all the potential hazards associated with a chemical." 51 Fed. Reg. 53280, 53295-96 (Nov. 25, 1983). Although the hazard communication standard's approach may be appropriate for early warning purposes and for triggering on-site training, labeling and material safety data sheets to address normal and emergency

situations, it is not appropriate for triggering notification to employees that an actual risk of disease is present. Such notification, in view of its consequences for both employers and employees, is appropriate only where a balanced review of all of the scientific evidence indicates that a significant risk is present. Further, Section 4(b)(3)(C) mandates notification of a minimum of 100,000 employees per year and states that the risk assessment board must undertake "every reasonable effort" to notify 300,000 employees per year. Application of this arbitrary threshold requirement would not reflect a reasoned consideration of the scientific evidence regarding the existence of an actual, significant risk.

The designation of a class of employees as an "at risk" category may thus stimulate an insurance industry expectation that higher health care costs and mortality rates would be associated with those employees. It also may cause an increase in spurious workers' compensation and liability claims by employees who are falsely led to believe that their condition resulted from occupational exposure, as well as needless anxiety among such employees. SOCMA believes that any notification should be based on sound science and have a demonstrable benefit. In addition, to avoid unwarranted alarm any notification should include as a component a realistic evaluation of the employees exposure, of the likelihood of actual harm, and of the degree of excess exposure that is present.

II. IMPACTS OF S. 79 ON CHEMICAL COMPANIES AND THEIR EMPLOYEES

The substantial over-notification that would result from S. 79 would have significant impacts for SOCMA's members in terms of: (1) the availability and cost of health and life insurance for employees; (2) an increase in spurious workers' compensation and liability claims and associated insurance availability problems; and (3) imposition of the substantial cost of medical surveillance in situations where it is not warranted. These impacts would be particularly burdensome for SOCMA's small business members.

A. Availability and Cost of Health and Life Insurance

The majority of SOCMA's member companies provide insurance benefits to employees, typically in the form of health insurance and life insurance. These insurance benefits are a essential component of the overall compensation package offered by employers. Over the past several years, insurance premiums have significantly increased, and in some cases individuals identified as being in certain "high risk" categories have been denied insurance. SOCMA is concerned that S. 79 could have the unintended impact of significantly increasing the cost of, or eliminating the availability of the insurance programs offered to employees. These impacts may be particularly acute for small businesses, who do not have the capacity to self-insure and who rely on their insurance programs as an important aspect of their compensation package to compete with larger companies for capable employees.

A recent survey of SOCMA's membership revealed that all of the member companies responding currently provide health and life insurance to their employees.^{2/} Of these companies, about 70 percent do not self-insure, but rather turn to the insurance industry for reasonable, affordable benefit packages.^{3/} Insurance premiums for these companies have increased up to 100 percent in the past five years; the median increase was 28 percent.

SOCMA believes it likely that enactment of S. 79 would result in additional significant increases in the cost of insurance, particularly for small businesses, and in some circumstances may result in elimination of insurance availability. At the present, the insurance industry generally does not question SOCMA's small member companies about the potential hazards associated with chemicals in their workplaces. As a general rule, insurance companies have performed actuarial risk analysis by first pooling small groups

2/ A broad-based survey of the U.S. workforce by the U.S. Chamber of Commerce recently determined that 86 percent of all companies provided health insurance benefits to employees. Research Center, Economic Policy Division, U.S. Chamber of Commerce, Employee Benefits 1985, at p. 18.

3/ The companies who do not self-insure generally are small businesses who do not have sufficient employees to diversify risks or are located in states prohibiting self-insurance. Among the small businesses, over 80 percent turn to insurance carriers for coverage. The survey also indicated that self-insurance is prohibited in New Jersey, Texas, and West Virginia.

with others to form a larger population. The risk is then calculated for the entire population group based on community ratings, experience ratings or a combination. The higher the expected health care costs, the higher the premiums.^{4/}

If S. 79 is enacted, it is likely that the insurance industry would separate out specific companies from the general pool based on the requirements for employee notification. The testimony of the Blue Cross and Blue Shield Association before the 99th Congress is instructive:

In dealing with small insured groups Blue Cross and Blue Shield Plans consider them as part of a pool and calculate a small group premium based upon spreading the risk more broadly across the composite, "super group." This is done in an effort to set affordable premium rates in a part of the market where, due to small group size, changes in the health status of few groups members can have a huge impact on the financial risk a small group presents. In small group pooling or community rated situations, which generally involve employers of 100 or fewer persons, the higher risk of health care costs presented by "notified" employees would thus be spread across a larger population. If S. 2050's mandated benefits were to create significant costs in this already difficult to insure segment of the market, competitive forces could pressure Blue Cross and Blue Shield Plans to discontinue pooling and instead rate each small group according to the risk which it alone presents. This would result from healthier small groups refusing to "subsidize" the

4/ See Committee on Risk Classification, American Academy of Archives, "Risk Classification Statement of Principles," June 1980, Exhibit 1.

cost of S. 2050's special benefits for persons in other small groups. If this were to happen, the the smaller the insured group the greater its premium increase would be, due to the inclusion of "notified" employees. In some cases, small employers might find health insurance altogether unaffordable.

Statement of the Blue Cross and Blue Shield Association on S. 2050, May 15, 1986, Exhibit 2, at p. 8.

After enactment of S. 79, the small businesses in the chemical industry with employees designated as "at risk" thus would lose the benefits of pooling into a large population group. SOCMA believes that notification would be taken into account by insurance companies and would inevitably lead to higher premiums, because the experience base in a small company may be of an insufficient size to be an adequate predictor and because notification likely would lead to an increase in health claims, whether justified or not.

SOCMA also is concerned about whether insurance would continue to be available to notified employees at any price. Numerous insurance companies have already moved away from providing health benefits to population groups that are determined to be in high risk categories. Although dramatic, the elimination of insurance availability for individuals exposed to the Acquired Immune Deficiency Syndrome (AIDS) virus led the District of Columbia to enact anti-discriminatory

legislation.^{1/} Similarly, designation of certain employees as "at risk" by a governmental entity may have the effect of eliminating the availability of insurance to cover such employees.

B. Effect on Workers' Compensation and Liability Insurance

SOCMA believes that S. 79 may trigger spurious workers' compensation and product liability actions by employees designated as "at risk," thus imposing significant unwarranted costs on the chemical industry and exacerbating the current difficulties in obtaining workers' compensation and liability insurance. The ability of companies to obtain such insurance at reasonable cost is an essential precondition to the conduct of business in the chemical industry.

The litigation against chemical companies resulting from S. 79 in many cases would be without merit but nonetheless would require significant expenditures to defend. Much of the litigation likely would involve employees with diseases from causes other than occupational exposure, employees who sue for fear of contracting a disease, or employees who sue because of a falsely perceived increased likelihood of contracting a disease. In addition, notification could inappropriately suggest liability in workers' compensation actions. As discussed above, these effects are exacerbated because S. 79

^{5/} D.C. Law 6-132, Exhibit 3.

would result in substantial over-notification to employees who, in actuality, are not at increased risk. Consequently, notified employees may attribute to their occupational exposures conditions actually based in other causes.

A similar response to publicity about a potential risk has been observed in other contexts. For example, after polybrominated biphenyls (PBB) were introduced into the food chain in Michigan in 1983, a number of spurious health effects claims were observed. A study of 23 farmers with disabling health complaints that they believed to be associated with PBB, which included a systematic evaluation of possible adverse effects, concluded that the patients "were not found to have objective evidence of deleterious effects at this time" and that "[t]here was no relationship between PBB levels and physical or laboratory abnormalities." Stross, et al., "Human Health Effects of Exposure to Polybrominated Biphenyls," 58 Toxicology and Applied Pharmacology 145 (1981), Exhibit 4. Therefore, any notification must be carefully based on sound science, be expressed in terms understandable to the individual notified, and be designed to serve a demonstrable medical benefit in order to avoid unwarranted impacts on the chemical industry.

Even without enactment of S. 79, workers' compensation and liability insurance has become a significant issue. Alleviation of the current liability insurance crisis was

recently identified as the highest priority issue of the sixty final recommendations of the White House Conference on Small Business during 1986,^{6/} and the limited availability of liability insurance to physicians and municipal governments has been well documented. Several of our members have informed us of their current difficulties in obtaining such insurance. For example, Sterling Chemical Company recently completed a plant purchase in Texas City, Texas, in which one of the major issues was the placement of workers compensation and liability insurance. Although a number of major insurance companies were asked to provide coverage, only one company was willing to provide a quotation. The insurance that was obtained was at a very high premium and imposed restrictive policy terms and conditions. In response, some chemical companies have been forced to pool together to form captive insurance companies to provide coverage,^{7/} and a number of states have implemented revisions to their workers' compensation programs to restrict benefits in order to continue to attract industry.^{8/} S. 79

6/ The White House Conference on Small Business, A Report to the President of the United States, Nov. 1986, Exhibit 5, at 21-22 (stating that "the liability insurance crisis in the United States has not only become a life and death sentence to many small businesses, but also is changing adversely our way of life . . .").

7/ "Chemicals Go to Captives for Coverage," Chemical Week, Feb. 11, 1987, at 68, Exhibit 6.

8/ See, e.g., "Worker's Comp Bill Encounters Snags in Md.," Washington Post, Feb. 18, 1987, at B1, Exhibit 7.

would exacerbate this already-serious problem.

C. Costs of Medical Surveillance

S. 79, as currently drafted, may impose costs of medical surveillance on employers in situations where it is not warranted. These costs would be particularly significant to small businesses, which may be forced to use funds for medical surveillance that otherwise would be allocated to other employee benefits.

Medical surveillance can be very expensive. SOCMA has conducted a survey of the current medical surveillance practices of its member companies. Approximately 75 percent of the responding companies conduct medical surveillance programs. These programs cost an average of about \$175 per employee per year.^{9/} Moreover, there are significant indirect costs associated with medical surveillance that are difficult to quantify. S. 79 would require companies to incur both the direct costs of perhaps very expensive and sophisticated testing and the costs associated with

^{9/} Medical surveillance is performed in a variety of ways: full-time in-house physicians (15 percent of responding companies); physicians in-house on a part-time basis (30 percent); local clinic or hospital (50 percent); mobile medical service (35 percent). (Percentages add up to more than 100 because some companies use more than one method.)

transportation to a designated facility or approved physician, lost work time, and perhaps replacement help.^{10/}

The aggregate costs of the monitoring required by S. 79 would be substantial. In 1977, the National Institute for Occupational Safety and Health (NIOSH) conducted a study of the costs of notification and medical surveillance. NIOSH concluded:

Even when consideration is limited to carcinogens substantial costs are involved. The total cost associated with workers currently exposed to OSHA-regulated carcinogens full-time is around \$424 million. The cost for both full and part-time workers is nearly \$8.5 billion. . . . If consideration is extended to workers currently exposed full-time or part-time to any OSHA-regulated substance, total program costs are estimated to be \$54 billion.

NIOSH, "The Right to Know: Practical Problems and Policy Issues Arising from Exposure to Hazardous Chemical and Physical Agents in the Workplace," July 1977 (prepared at the request of the Subcommittee on Labor, Senate Committee on Human Resources), Exhibit 8, at 28. Ten years later, the costs of the program would be even higher.

In view of the substantial expense of medical surveillance, it should be required only in those circumstances

^{10/} In many cases, particularly for small businesses involved in specialized operations, replacement personnel may not be available.

where a discernable medical benefit would result. S. 79, as currently drafted, requires the Board to consider populations "likely to benefit" from medical surveillance or health counseling in making the notification decision. However, S. 79 does not provide criteria for determining the extent of medical surveillance, if any, that would be appropriate. SOCMA believes that the Board should be required to consider the costs associated with medical surveillance and the benefits that would accrue in specifying the type and frequency of medical surveillance that would be appropriate.

In this regard, SOCMA has surveyed its members regarding the outcome of existing medical surveillance programs. Medical surveillance has resulted in detection of occupationally-related illnesses only in very rare cases. The typical percentage of monitored employees diagnosed with occupationally-related problems among companies reporting was less than one percent. These results, in conjunction with the high cost of medical surveillance, demonstrate that medical surveillance should not be required except in circumstances where a discernable medical benefit would accrue.

* * * *

S. 79 thus would impose significant impacts in the form of insurance that becomes significantly more expensive or unavailable, increased exposure to liability actions, and costs of medical surveillance. These impacts would be particularly

where for small businesses in terms of direct action, ability to allocate resources in view of other regulatory initiatives,¹²⁷ and the continued opportunity to compete with larger businesses for capable employees by offering attractive compensation packages. G. 7b may ultimately affect the competitive position of small businesses, and it is conceivable that some small businesses may be forced to abandon certain product lines or to close.

OSHA encourages the Board to take the important impacts that G. 7b would impose on the small business industry and its employees. Mechanisms to trigger administrative board action must scientifically demonstrate to ensure that proposed actions are truly at risk, and any such action must have a defined purpose and benefit. OSHA will not be expending the board resources devoted to non-manufacturing sectors. Through the right-to-know provisions of the Superfund Amendments, all individuals, including former employees, are entitled to the same information. These measures, as well as generic standards for national surveillance and monitoring, should be addressed and not under consideration at OSHA, are appropriate subject for

¹²⁷ Small businesses are generally faced with a significant "resource crunch" in complying with other regulatory initiatives, such as the Superfund Amendments and the Emergency Response and Relieving Right-to-Know provisions of the 1980 Superfund Amendments.

implementing the purposes of S. 79 without provoking a crisis in the small business community.

If we can be of further assistance, please do not hesitate to contact Judy Mokhtari, Manager, Occupational Safety and Health, at (202) 659-0060.

SYNTHETIC ORGANIC CHEMICAL
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March 5, 1987

EXHIBITS

1. Committee on Risk Classification, American Academy of Archives, "Risk Classification Statement of Principles," June 1980
2. Statement of the Blue Cross and Blue Shield Association on S. 2050, May 15, 1986
3. D.C. Law 6-132
4. Stross, et al., report on "Human Health Effects of Exposure to Polybrominated Biphenyls," 58 Toxicology and Applied Pharmacology 145 (1981)
5. White House Conference on Small Business, A Report to the President of the United States, Nov. 1986
6. "Chemicals Go to Captives for Coverage," Chemical Week, Feb. 11, 1987, at 68
7. "Worker's Comp Bill Encounters Snags in Md.," Washington Post, Feb. 18, 1987
8. NIOSH, "The Right to Know: Practical Problems and Policy Issues Arising from Exposure to Hazardous Chemical and Physical Agents in the Workplace," July 1977

COALITION FOR PROMPT PAY

March 10, 1987

Senator Dale Bumpers
Chairman, Small Business Committee
Attn: William B. Montalto
Senate Committee on Small Business
428A Senate Russell Office Building
Washington, D.C. 20510

Dear Chairman Bumpers:

On behalf of the Coalition for Prompt Pay, I am enclosing a statement for the record of the Committee's Small Business Issues and Priorities session. We appreciate being asked to participate and welcome the chance to share our views.

The enclosed statement is developed in question and answer format to meet some of the concerns raised during the Issues and Priorities session and to deal with questions raised by various Senate and House staffs during recent months.

As you know, we support S. 328, the Prompt Payment Act Amendments which you are co-sponsoring and we are very grateful for the leadership which the Senate Small Business Committee has given to this bill.

We look forward to working with you in the months ahead to win enactment of the Prompt Payment Act Amendments.

Sincerely,



Kenton Pettie
Director

Enclosure: Q & A on Prompt Pay

COALITION FOR PROMPT PAY

Q and A on Prompt Pay

The following are answers to questions asked by members of the House and Senate and their staffs. The answers are prepared by the Coalition for Prompt Pay which supports S. 328, the Prompt Payment Act Amendments.

1. ARE PROMPT PAYMENT PROBLEMS WIDESPREAD THROUGHOUT THE GOVERNMENT, OR ARE THEY CONCENTRATED IN A FEW AGENCIES OR PAYING CENTERS?

Coalition Answer: The complaints we receive indicate that late payments occur in most Federal agencies. Companies call us from all over the country indicating that it is not a problem concentrated among Washington, D.C. area agencies. In particular, we have received particularly steady flow of complaints about late payments by the U.S. Navy. In fact, late pay by the U.S. Navy has been the subject in part of two Congressional hearings: January 17, 1984 in Portsmouth, VA (House Small Business) and December 2, 1985, in Norfolk, VA (Senate Small Business). As the hearing record will show from the December 2 hearing, companies complaining about the U.S. Navy find similar problems with many other Federal agencies. Companies testifying in these hearings referred to finance and payment centers located all over the country. The hearing record also shows that within agencies, some payment centers do a better job than others. The problem is government-wide.

2. WHAT ASPECT OF THE PAYMENT PROCESS APPEARS TO BE THE PRIMARY CAUSE OF LATE PAYMENTS?

Coalition Answer: There is not a single cause. If there were just one major cause, we could concentrate the legislative and administrative remedies around that cause. Instead, we recommend that there be a remedy for each cause thus creating a network of incentives which cause prompt pay no matter what excuse (or cause) is being offered.

March 19, 1987

Primary Causes:

- A. Failure to act promptly by those who must approve paperwork, such as acknowledging receipt, certifying job completion, or accepting final work. Under the Act and OMB Circular A-125, these people are under no pressure to get the paperwork processed. Their agency is not penalized for being slow with paperwork. They can go on vacation, travel, or be temporarily assigned to another agency and not incur any penalties for leaving a pile of unpaid, unprocessed invoices or payment documents. While the payment office may be telling the vendor "we haven't received any OK to pay this bill yet," the person responsible for the OK may be attending a three-week training program in Monterey, CA. The payment office rarely acts as an expeditor but rather hides behind this catch-22: "I would pay you but someone else hasn't sent me the paperwork yet. Of course, once I get the paperwork, I have to wait 30 days before I can process the check."

S. 238 will solve this by insisting on no more than five days for receipt and certification, unless otherwise specified in the contract.

- B. Failure to promptly forward evidence of receipt or completion of the service directly to the payment office. Under the Act and A-125, there is no penalty for delaying a receiving report. The quarterly OMB survey of agencies does not ask agencies how long they take in processing receiving papers.

In the case of food products, the products may have been eaten long before the government officially acknowledges "receipt." In the case of a photocopy machine, thousands of copies may have been run off before the government acknowledges the machine's arrival. In the case of a projector being delivered to a ship, the ship may have completed a six-week tour of the Caribbean before receipt is acknowledged. In the case of items shipped to a dozen missile sites, a late receiving report from one site could cause payment for all deliveries to be delayed by months.

- C. Failure to make the payment within the 30 days but rather extending the payment into the 15-day grace period. There is no incentive to encourage the agency to meet the 30th day deadline. The 44th day is just as good. There is no penalty for issuing the check on either day--despite the intent of Congress which established the 30th day as the deadline.

The GAO is very conservative in stating that 20% of payments are made in the 15-day grace period. I have seen printouts showing that some payment centers make most of their payments between the 30th and 45th days.

No one in the agencies feels pressure to pay before the 30th day. In fact, OMB just says pay on or about the 30th day. That's like my telling my daughter to be ready to come home "around 9 P.M."--inevitably her interpretation of "around" will be "up to 10 P.M. is OK."

We are pleased that even OMB agrees the grace period should be eliminated. S. 328 would phase it out by 1990.

The 30th day as a deadline has to be solid to prevent the erosion that has taken place since passage of the Act in 1982.

- D. Failure to take any steps to remedy a situation that is precipitating a late payment. The Act requires that the agency notify a vendor when payments are going to be late. However, no vendors receive this notification. The Act says that if a problem is detected with an invoice, the vendor must be notified within 15 days. This means that the agency should have examined the invoice within 15 days of receipt. But, the 15-day rule is ignored by procurement and finance offices. Problems that could be solved quickly are left to languish. Invoices that are deemed "improper" due to misunderstanding or mistake by the vendor are left hanging indefinitely--until the vendor (exasperated) makes a half-dozen calls to see what happened that is making the payment late.
- E. Failure to be clear about where the invoice is to be sent. Companies complain that agencies require them to send invoices to the procurement office for approval rather than to the finance office. This has the effect of delaying the 30-day clock until the procurement or program office OK's the invoice. Other companies complain that when they send the invoice to the wrong office the invoice is discarded or "lost." Agencies are never penalized for delays which are caused by "lost" paperwork. Yet, agencies sometimes cause the paperwork jungle by making paperwork requirements of companies that are so complicated as to invite disaster along the way. Take the situation in which the company made shipments to 13 points, sent the invoice to a 14th point and was to receive payment from a 15th point. The order was issued from a 16th point, which had received approval from a 17th point, the procurement office. In this example there are far too many points where a mistake can result in late payment.
- F. Failure to streamline bureaucratic procedures. Even though the Congress has doggedly pursued a reduction in government paperwork, there is still far too much paperwork going on in the government's payment process. While some agencies have converted to computer systems since passage of the Act, many of the computer systems are dedicated to the payment process alone. The receiving and acceptance stages are not keyed in. So, when a vendor inquires "What's the status of my payment?" the finance office can only answer "I haven't received all the paperwork yet. I don't know where the problem is. You'll have to find out yourself."

To be efficient, the computer system must be so configured that receiving and acceptance can be logged in electronically. In most cases, there is no need for an elaborate pile of paper. The same goal, with the same degree of security, can be accomplished by electronic storage and retrieval.

There continues to be a bureaucratic wall between the procurement functions and the payment functions of agencies. Each blames the other and no one takes responsibility. The OMB annual report to the Congress is a measure of how well the finance offices are doing but does not measure how well the procurement offices are doing. The report should measure both sides of the payment process.

The Act has definitely caused some improvement. But until the statute is amended to close the receiving, acceptance and certification delays as proposed in S. 328, there will be no incentive to streamline, to cut out a lot of paperwork, and to turn to electronic payment approval.

3. WHAT PROBLEMS HAVE VENDORS ENCOUNTERED REGARDING DISCOUNT OFFERS?

Coalition Answer: Some companies trying to encourage prompt pay, offer discounts for payments which are made in 10, 15 or 20 days. The companies want the discount offer to encourage agencies to look at the goods or service immediately and to process the invoice immediately.

But, the government frustrates the offerors by abusing the discount. Rather than expedite receiving, acceptance and certification, the agency may take months but goes ahead and takes the discount anyway. This is a clear violation of the 1982 Act.

However, the agencies justify it on the following grounds:

The discount does not apply until all the paperwork has been accumulated in the finance office. At that time, on commencement of the 30-day count, the 10-, 15-, or 20-day count begins.

As a result, agencies take millions of dollars worth of discounts by breaking the law but hiding behind a loophole. We recommend that, by amendment to the statute, this loophole be closed by clearly tying such discounts to the date of the arrival of the invoice in the finance office, regardless of the tardiness of the paperwork wending its way up from the procurement office. Further, the statute should be amended to double the penalty on agencies which proceed to take the discount after the discount period has expired. These amendments would strike at this particular problem.

4. WHEN VENDORS OFFER A DISCOUNT, HOW DO THEY EXPECT THE AGENCY TO CALCULATE THE DISCOUNT PERIOD?

Coalition Answer: It is the vendors' intent that the discount period begins when the agency receives the invoice. The discount is offered as an incentive to hustle the invoice through the approval channels. The discount is a reward for expediting the payment process. For the reward to work properly, the agency has to accept the date of the arrival of the invoice as the date on which to base the discount period.

In contrast, agencies today pick when they want the discount period to begin.

If the agency delays payment and then takes the discount, the agency has, in effect, chosen when the discount period is to begin. Companies have shown us cases in which discounts have been taken many months after the discount period expired. When asked by vendors "Why did you do this?", the agencies often reply "Because we are required to take all discounts offered."

5. WHAT SHOULD THE GOVERNMENT BE DOING ADMINISTRATIVELY TO REMEDY THE PROMPT PAYMENT PROBLEMS THAT VENDORS ARE EXPERIENCING?

Coalition Answer: The Coalition believes that since adoption of the Act, OMB has done all it can to solve the problem through administrative means. Other than admonish agencies to do a better job, and collect annual data on the subject, OMB has little leverage to get improvements on the administrative level.

In our opinion, new administrative steps should be taken in response to amendments to the 1982 Act. Amendments to the Act, including increased penalties for administrative failures, will provide the incentive for administrative changes, streamlining of procedures, and reduction of paperwork.

In particular, we recommend:

- A. Each agency should publish a booklet explaining "how to get paid by this agency" and should distribute it to all vendors doing business with or considering doing business with, the agency.
- B. OMB should publish twice a year a list of the top financial officers in each agency. These are the people who, when all else fails, should be asked to step in and act as ombudsperson. Unless the top financial officer has a working knowledge of the problems vendors experience, and is involved in solving the problems by administrative improvements, the agency will continue to pay late.
- C. Each quarter, OMB should seek information concerning both prompt and late payments:
 - o How long does it take for receiving reports to reach the payment office?
 - o How long does it take for acceptance and certification reports to reach the payment office?
 - o How many payments are made after the discount period has expired?
 - o How many payments are made in the grace period?

- o How many payments are made late, based on an aging process that identifies payments unissued after 60 days, after 90 days, after 120 days, etc., and what are the reasons these payments have not been issued?
 - o How many payments have been made under the "fast pay" plan in which prompt pay is assured under certain limited circumstances?
 - o How often does the "fast pay" system succeed or fail to meet its goals?
 - o Does the agency have a "How to get paid by this agency" booklet?
 - o How many troubleshooting requests has the chief financial officer received?
 - o What improvements have been instituted in moving to electronic transfer of financial information, streamlining procedures and eliminating paperwork?
6. IF THE PROPOSED PROMPT PAYMENT REVISIONS TO THE FEDERAL ACQUISITION REGULATION (FAR) ARE NOT CHANGED, WHAT MORE WILL BE NECESSARY TO IMPROVE THE GOVERNMENT'S BILL PAYING?

Coalition Answer: The proposed changes to the FAR issued in 1986 are entirely, and completely inadequate. They undermine the intent of the 1982 Act. They represent a crude and altogether cynical approach to prompt payment.

The proposed FAR provisions are an invitation to litigation, pitting the vendors against the government in a contest to get the Court of Claims to decide on the intent of Congress. A far better way for the intent of Congress to be communicated would be for the Act to be amended as proposed by S. 328 to cut off the FAR provision before it becomes the guideline for all government procurement agencies.

Congress should act immediately to amend the 1982 Act to reassert the intent and instruct the FAR writers on how to write the rules correctly. We are not confident that the final version of the FAR provision will be acceptable to industry because it is being written by those who are more concerned about the government's views than the intent of Congress or the cashflow of private firms.

7. HAVE VENDORS EXPERIENCED PROBLEMS RELATING TO PAYMENTS FOR MEAT AND PERISHABLE AGRICULTURAL PRODUCTS?

Coalition Answer: Yes, there have been complaints about late payments for meat and other perishable products. These products have standards of less than 30 days but are sometimes paid for under the 30-day standard. Agencies fail sometimes to make the special 7-day and 10-day distinctions called for by the Act.

The most recent problem has emerged under payments owed by the Commodity Credit Corporation (CCC). On June 25, 1986, the CCC issued a notice to "All Red Meat Contractors" which states:

"Bidders and contractors are advised that CCC takes the position that the Prompt Payment Act referenced in the procurement documents is applicable to an agency's administrative failure to make timely payments on purchases, but does not extend to situations where an agency's inability to make payment is due to circumstances beyond the agency's control such as occurred with respect to depletion of CCC's borrowing authority."

This CCC notice is a direct violation of the Act. The 1982 Act gave no agency authority to suspend the application of the Act. Only OMB was given the authority to issue regulations promulgating the Act, and OMB has not given the agencies any authority to suspend application of the Act. We doubt if even OMB has the legal authority to suspend application of the Act. Only Congress can change what it has enacted on this subject. The General Accounting Office agrees with our view. "On March 4, 1987, GAO ruled that the CCC plan "violated the Prompt Payment Act."

In the case of the payments owed by the CCC, under the Act interest penalties would accumulate on a compounding basis until the CCC is in a position to pay. Under no circumstances should the CCC be able to skip the interest penalties called for in the law.

To allow CCC to do otherwise would begin a round of exceptions on the part of other agencies in which other excuses for late payment would trigger rules that suspend the application of the Prompt Payment Act.

The Coalition believes that the 1982 Act should be amended to state that "no agency shall have the authority to suspend the application of the provisions of this Act."

8. WHAT PAYMENT PROBLEMS DO VENDORS ENCOUNTER WHEN THEIR CONTRACTS INCLUDE PAYMENT-TIMING TERMS THAT DIFFER FROM THE USUAL 30-DAY PAYMENT PERIOD?

Coalition Answer: Companies with payment terms that are less than the 30-day standard find their payment terms are ignored. Agency personnel state "We are not authorized to adhere to the terms in your invoice."

The problem here is that some industries, particularly those selling products with a short shelf life, have industry-wide terms that require all customers to pay, for example, in 15 days or 20 days. Only the government slips out from under these industry-wide terms. As a result the government is probably paying more for the goods it buys while other non-government customers are paying for some of the costs involved in excessive time Federal agencies take to pay.

9. HOW HAS OMB'S DIRECTIVE THAT AGENCIES AVOID EARLY PAYMENT AFFECTED THE TIMELINESS OF PAYMENTS IN GENERAL?

Coalition Answer: The problem is in the definition of "early." For OMB, anything paid on or before the 27th day is "early." The 27th day could be the 85th day after the job was done or the goods were delivered! The 27th day could be long after an early discount deadline has been missed by an agency.

In other words, by making the 27th day as the demarkation line between early and late, OMB has forced an entirely unrealistic lock on agencies and vendors alike.

Under the OMB rule, agencies are denied the flexibility to make a payment that has been delayed by too much time taken in receiving, accepting and certifying. If the finance office knows that a vendor has been waiting on a payment for two months, why does that office have to wait until after 27 more days have passed before issuing the check?

The only reason why is "That is the rule according to OMB." The way OMB enforces this rule is that in its quarterly survey of agencies it defines "early" as all payments made before the 27th day. And as stated above, this "OMB 27th day" is not the 27th day after delivery but the 27th day after the bureaucrats have finished shuffling the paperwork through the red-tape maze.

In effect, OMB's 27-day rule has caused many payments to be made later rather than prompter. Therefore, OMB has thwarted the intent of the law.

The remedy is in OMB making its rule more flexible. The agencies should have clear authority to make the payment anytime in the 30 days they feel is appropriate. In cases where long delays have bogged down the payment process, there should be immediate payment once the paperwork is in the finance office rather than delayed payment. Immediate payment should be the rule in these cases rather than the exception.

On this point, OMB hides behind the cloak of "cash management." But, in effect, they are perpetuating the late payment syndrome that brought Congress to adopt the Act in the first place. I have discussed this with finance managers in agencies and they say "Your problem is with OMB. Our hands are really tied on this."

The Coalition feels that the Act should clearly state that payments already late (due to delays in the procurement or program office) may be paid anytime within the 30 days and where possible should be paid as promptly as possible. Artificial delays of 27 to 30 days should be prohibited by the Act.

10. WHAT PROBLEMS ARE CAUSED WHEN CONTRACTS REQUIRE VENDORS TO SUBMIT THEIR INVOICES TO AN AGENCY OFFICE THAT IS NOT THE PAYING OFFICE?

Coalition Answer: As mentioned in an earlier answer, as the number of offices dealing with a particular payment increases so does the red tape and the chance of late payment.

If an agency wants the vendor to ship to one site, bill to another and receive payment from still another, there should be one rule applying to when the 30-day count begins.

The intent of the Act was that the 30-day count begin on the later of the receipt of the goods or services or the receipt of the invoice. But, GMB has held that the 30-day count only begins when everything reaches the finance office.

We recommend that the 30-day count begin, as proposed in S. 328, in whatever office the agency designates as the place the company sends the invoice. The pressure should be on the first recipient of the invoice: process it promptly. To allow otherwise is to leave a major loophole in the law. The Coalition believes that the only effective way to accomplish this is through amending the Act.

11. WHAT IS YOUR POSITION ON SECTION 7 OF S. 328? WHAT DO YOU RECOMMEND THAT CONGRESS DO ABOUT THE PROBLEM OF LATE PAY TO SUBCONTRACTORS?

Coalition Answer: Ever since the 1982 Act was adopted the Coalition has received complaints from subcontractors. The complaints run along these lines: "OK, you've done something for the prime contractors, the general contractors, but you haven't helped the subcontractors. We're still getting paid late."

These subcontractors feel that they are doing their work on a Federal installation, meeting Federal specifications and job requirements, and following dozens of Federal rules that are passed on to them in their contracts. But, when it comes to payment, there is no help from the Federal agency involved.

In fact, many Federal contract officers will not talk to, or share information with, subcontractors. So, often subcontractors are denied information they need to pursue payment claims against their prime contractor.

This is clearly a problem that should be dealt with in S. 328. That is why the Coalition, except for two of its members, supports Section 7 again this year, as we did prior to Senate passage of a similar provision in the 99th Congress.

Section 7 will encourage more small firms to work as subcontractors and will improve the competition for subcontracting on Federal construction, installation, and remodeling projects.

12. SHOULD A SUBCONTRACTOR BE PAID BEFORE THE GENERAL CONTRACTOR RECEIVES PAYMENT FROM THE GOVERNMENT?

Coalition Answer: We support Section 7 of S. 328 because this provision simply requires that when a general contractor receives payment from a U.S. agency which is for work done by a subcontractor, that the money owed the subcontractor be paid promptly.

Section 7 is a "penalty" provision. It does not require that the subcontractor be paid before the general contractor is paid. Most representatives of general contractors have alleged that Section 7 would force general contractors to pay before the government has paid. This allegation is not a correct interpretation of Section 7.

13. WHY DIDN'T THE BUSINESS COMMUNITY WAIT FOR THE ADMINISTRATION TO MAKE THIS LAW PAY PEOPLE OFF? According to testimony presented at the office of HARRINGTON AND BUNNETT in the summer of 1961, there are several reasons for this delay.

LEGISLATION DELAYED They have had since 1960 to solve the problem. There have been four Congressional hearings on the subject since then and each time the executive branch has been urged to move. In fact, later than 1960 promised that there would be improvements.

But, they have not delivered on their promises.

Even if they did, there are several important things that can only be done through S. 328 which cannot be done by SSB or the executive agencies. Even SSB recognizes this and has endorsed S. 328 according to testimony by Joe Wright, Deputy Director, Federal Reserve Board, Committee on Monetary Affairs, Committee.

For example, elimination of the 15-day grace period which has been strictly abused, can only be accomplished by passage of S. 328. There are several other provisions in S. 328 that can only be done by statute. All the provisions in S. 328 are being done by statute because that is the only way to ensure a permanent solution.

We feel we have waited far too long as it is. We fully support the 1962 Act to end the problem. If the agencies had wanted to achieve the intent of the 1962 Act, maybe the business community would not have so strongly opposed this issue. But the government has been reluctant, uncertain, and inconsistent. That is why we need S. 328.

14. WHAT HAVE THE STATES DONE TO RESOLVE THE PROBLEM FOR BUSINESS OF THE STATE LEVEL?

LEGISLATION DELAYED Since 1960 there have been four pending private pay laws. In December the Committee for State Budgets Act, which has been advocating these state laws, I can report there are 30 states with private pay laws. Each of these laws requires business contractors to be paid when a government agency is paid. But all the state laws are so strong as to be weak. In fact, the Federal law is doing the best version of all the statutes we are familiar with.

We are very grateful to the leaders of Congress and all the legislators who have worked with us the state level who have made possible this effort of success.

